

**The Statewide Single Audit of the Commonwealth of Kentucky  
For the Year Ended June 30, 2006**

**BACKGROUND**

The Single Audit Act of 1984, subsequent amendments, and corresponding regulations, require the auditing of financial statements and the compliance and internal controls applicable to federal moneys received by the Commonwealth.

**STATE AGENCIES EXPENDED MORE FEDERAL AWARDS IN FY 06**

Total federal expenditures increased by \$413,961,875 in FY 06. State agencies expended \$7,362,077,862 in federal awards in FY 06, whereas state agencies expended \$6,948,115,987 in federal awards in FY 05.

**FINDINGS IN FY 06**

There were 3 fewer findings in FY 06 than in FY 05. There were 69 findings for FY 06, compared with 72 findings in FY 05. Of the 69 findings for FY 06, 44 were related to the financial statements, and 25 were related to federal awards. One of the 69 FY 06 findings was related to both the financial statements and federal awards.

**NEW FINDINGS FOR FY 06**

Cabinet for Health and Family Services

- Should Implement Procedures To Ensure Services Are Received Prior To Paying The Full Contract Amount
- Should Strengthen Controls Over The Processing Of Vendor Payments
- Should Maintain Adequate Documentation For Contract/Vendor Payments
- Should Obtain A SAS 70 Audit
- Should Strengthen Controls Over The Processing Of Contract Payments
- Should Document the Reconciliation Of Quarterly Financial Reports For The Adoption Assistance Program
- Should Ensure Policy And Procedures Are Adhered Too And Maintain Adequate Records
- Should Ensure The Jefferson County Child Support Enforcement Office Has Appropriate Approvals For Computer Equipment Purchases
- Should Ensure Financial Records For Administration Of The Child Support Enforcement Program Remain On-Site At The Meade County Attorneys Office At All Times

Commerce Cabinet

- Should Ensure The New West Branding Contract's Billing Procedures Are Improved

Department of Employee Insurance

- Should Ensure All Public Funds On Deposit Are Secured

**The Statewide Single Audit of the Commonwealth of Kentucky  
For the Year Ended June 30, 2006  
(Continued)**

**NEW FINDINGS FOR FY 06 (CONTINUED)**

Department of Corrections

- Should Strengthen Logical Security Procedures Surrounding The ORION Application
- Should Strengthen Logical Security Procedures Surrounding the VINE Application
- Should Strengthen The Security Of System Accounts

Department of Education

- Office Of District Support Services Should Update And Consistently Apply Its Change Management Process
- Office Of District Support Services Should Formalize And Consistently Apply Its Logical Security Policies
- Office Of District Support Services Should Ensure Proper Segregation Of Duties
- Should Implement A Comprehensive Information Technology Policy And Ensure Adequate Oversight Authority Is Established
- Office Of Education Technology Should Formalize And Consistently Apply Logical Security Policies For The KETS Network And MUNIS
- Should Formalize The Task Order Process And Ensure Business Units Review Contractor Performance

Department of Fish and Wildlife

- Should Develop Policies And Procedures Over All Job Duties, Retention of Accounting Records, And Timely Vendor Payments
- Should Make Use Of All State Financial Accounting System Components For Proper Administration Of Federal And State Resources
- Should Implement Its Internal Policies And Procedures Over Vendor Invoice Payments
- Should Develop Policies And Procedures Over Payroll Errors
- Indirect Cost Rates Should Agree To Federally Approved Indirect Cost Rates

Department of Military Affairs

- Should Document Costs Charged To The AIOM Tenant Sub-Project, Including An Approved Cost Allocation Plan For Shared Facility Costs
- Should Properly Request And Document Grant Extensions

Department of Revenue

- Should Work With COT To Strengthen Controls Governing Data Processing Of Taxpayer Accounts
- Should Ensure Access To Production Libraries Is Limited
- Should Ensure That Formal Program Modification Control Procedures Are Developed And Implemented
- Should Implement Procedures To Protect Cigarette Tax Stamps

**The Statewide Single Audit of the Commonwealth of Kentucky  
For the Year Ended June 30, 2006  
(Continued)**

**NEW FINDINGS FOR FY 06 (CONTINUED)**

Department for Workforce Investment

- Should Ensure Federal Reports Reconcile To The State's Accounting System On A Quarterly Basis By Reporting Category

Finance and Administration Cabinet

- Should Ensure Contracts Are Being Monitored For Vendor Compliance As Specified In The Contract
- Division Of Fleet Management Should Implement Procedures To Investigate And Communicate All Potential Fleet One Card Discrepancies
- Kentucky State Police Should Improve Procard Controls
- Should Develop And Implement Formal Policy And Procedures To Govern The Security Of The Management Administrative And Reporting System Checkwriter Interface Process

Kentucky Higher Education Assistance Authority

- Should Send Notices To Borrowers Timely
- Should Be Subrogated To The Federal Government In A Timely Manner

Kentucky Higher Education Student Loan Corporation

- Should Closely Monitor Data Transmissions

Kentucky Retirement Systems

- Should Ensure Internal Controls Are Adequate To Prevent Overrides

Kentucky State Treasury

- Should Only Process Wire Transfers For Which Sufficient Funding Exists
- Should Improve Controls Over The Disbursements And Computer Application Access/Modification Processes
- Should Develop A Disaster Recovery Plan And Ensure Adequate Documentation Is Stored Off-Site In The Event Of An Emergency Situation
- Should Reconcile Commonwealth Bank Accounts With MARS In A Timely Manner

Personnel Cabinet

- Should Implement Formal Policies Governing System Access To The Group Health Insurance And Premium Billing And Reconciliation Systems
- Should Adhere To Established Procedures Governing System Access Requests For The Uniform Payroll And Personnel System

**The Statewide Single Audit of the Commonwealth of Kentucky  
For the Year Ended June 30, 2006  
(Continued)**

**NEW FINDINGS FOR FY 06 (CONTINUED)**

Transportation Cabinet

- Should Ensure That Logical Security Procedures Are Consistently Applied For The Trns\*port SiteManager System
- Should Strengthen Internal Controls On Timecards And Implement Proper Segregation Of Duties
- Should Implement Reconciliation Procedures To Accurately Account For Infrastructure And Provide Additional Management Oversight
- Should Improve Procedures To Ensure The Correct Certification Letter For Materials Is Submitted To The Federal Highway Authority

**RECURRING FINDINGS FOR FY 06**

Cabinet for Health and Family Services

- Should Strengthen The Security Of System Accounts
- Should Maintain Proper Supporting Documentation For Case Files

Department of Fish and Wildlife

- Should Develop Procedures Requiring Cash Draw Downs Within A Reasonable Time Frame, And Requiring Retention Of Supporting Accounting Records
- Should Inform Staff Of Receipt Handling Policies And Implement Policies Requiring Retention Of Accounting Records And Supporting Documentation

Department of Revenue

- Office Of State Budget Director Should Ensure That Tax Receipts Belonging to County Governments Are Properly Accounted For In The Fiduciary Fund At Year End

Department for Workforce Investment

- Should Implement Controls Over Systematic Programs To Ensure Accurate Information Is Available For Closing Package Reporting
- Should Strengthen Controls To Ensure The Accuracy Of Estimates In The Closing Package
- Should Implement Controls To Ensure Inactive Accounts Are Written Off Timely For Closing Package Reporting Purposes
- Should Review Closing Package Information To Ensure Accuracy
- Should Improve Review Procedures Over The Office Of Vocational And Adult Education Consolidated Annual Report Status Of Funds Form

**The Statewide Single Audit of the Commonwealth of Kentucky  
For the Year Ended June 30, 2006  
(Continued)**

**RECURRING FINDINGS FOR FY 06 (CONTINUED)**

Finance and Administration Cabinet

- Office Of Financial Management Should Develop And Implement Policies To Ensure Accounts Are In Compliance With Applicable Laws
- Should Improve Segregation Of Duty Controls
- Should Strengthen Logical Security Procedures Surrounding The Complete Asset Management, Reporting, And Accounting System
- Should Formalize And Consistently Apply The Program Modification Process For The Commonwealth's Cash And Investments System

Justice Cabinet and Public Safety Cabinet

- Should Implement Procedures To Ensure Subrecipient A-133 Audits Are Submitted Timely
- Should Implement Procedures For The Timely Submission Of Subrecipient Financial Reports

Transportation Cabinet

- Should Improve Inventory Procedures For Maintenance Materials
- Should Improve Procedures To Ensure Federal Reports Are Prepared Accurately

**STATE AGENCIES WITH UNRESOLVED  
FEDERAL AWARD QUESTIONED COSTS IN FY 06**

Cabinet for Health and Family Services	\$ 1,000,000 (FY 06)
	\$ 178,511 (FY 06)
	\$ 49,604 (FY 06)
	\$ 18,149 (FY 06)
	\$ 2,319 (FY 06)
	\$ 29,820 (FY 05)
	\$ 4,947 (FY 05)
	\$ 18,224 (FY 04)
	\$ 16,774 (FY 04)
	\$ 1,040 (FY 04)
Department of Agriculture	\$ 1,973 (FY 06)
	\$ 8,345 (FY 05)
Department for Fish and Wildlife Resources	\$ 670 (FY 06)

**The Statewide Single Audit of the Commonwealth of Kentucky  
For the Year Ended June 30, 2006  
(Continued)**

**STATE AGENCIES WITH UNRESOLVED  
FEDERAL AWARD QUESTIONED COSTS IN FY 06 (CONTINUED)**

Department of Military Affairs	\$ 8,003 (FY 06)
	\$ 6,332 (FY 06)
	\$ 3,854 (FY 06)
	\$ 40,188 (FY 05)
Department of Workforce Investment	\$ 103 (FY 06)
	\$ 77 (FY 05)
Education Cabinet	\$ 1,155 (FY 06)
	\$ 3,111 (FY 05)
Justice and Public Safety Cabinet (KSP)	\$ 23,944 (FY 06)
	\$ 16,661 (FY 05)
Kentucky Higher Education Assistance Authority	\$ 43,000 (FY 06)
Kentucky Office of Homeland Security	\$ 623 (FY 06)
	\$ 1,545 (FY 05)
Kentucky Transportation Cabinet	\$ 559,816 (FY 05)



CRIT LUALLEN  
AUDITOR OF PUBLIC ACCOUNTS

March 28, 2007

Honorable Ernie Fletcher, Governor  
Cabinet Secretaries and Agency Heads  
Members of the Commonwealth of Kentucky Legislature

As Auditor of Public Accounts, I am pleased to transmit herewith our report of the Statewide Single Audit of the Commonwealth of Kentucky for the year ended June 30, 2006. The Federal Government's Office of Management and Budget (OMB), per OMB Circular A-133 requires the Auditor of Public Accounts to perform the Statewide Single Audit of the Commonwealth of Kentucky.

To fulfill these requirements, the Auditor of Public Accounts, performs the following:

- An audit of the basic financial statements and combining and individual fund statements and schedules-nonmajor funds;
- Limited procedures applied to required supplementary information;
- An audit of the Schedule of Expenditures of Federal Awards;
- An audit of compliance with the compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* applicable to each major federal program;
- Tests of internal control over compliance in accordance with OMB Circular A-133;
- Tests of compliance with certain provisions of laws, regulations, contracts, and grants; and
- Tests of internal control over financial reporting.

The Auditor of Public Accounts also calculates a dollar threshold, based on OMB Circular A-133 guidance, to determine the federal programs to be audited for internal controls and compliance. For FY 06, the threshold for auditing federal programs was \$20 million.



Honorable Ernie Fletcher, Governor  
Cabinet Secretaries and Agency Heads  
Members of the Commonwealth of Kentucky Legislature  
March 28, 2007  
Page 2

On behalf of the Division of Financial Audit of the Auditor of Public Accounts' Office, I wish to thank the employees of the Commonwealth for their cooperation during the course of our audit. Should you have any questions concerning this report, please contact John Cubine, Director, Division of Financial Audit, or me.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Crit Luallen", with a long horizontal flourish extending to the right.

Crit Luallen  
Auditor of Public Accounts



**REPORT OF THE  
STATEWIDE SINGLE AUDIT OF THE  
COMMONWEALTH OF KENTUCKY**

**For The Year Ended  
June 30, 2006**



**CRIT LUALLEN  
AUDITOR OF PUBLIC ACCOUNTS  
[www.auditor.ky.gov](http://www.auditor.ky.gov)**

**105 SEA HERO ROAD, SUITE 2  
FRANKFORT, KENTUCKY 40601-5404  
TELEPHONE 502.573.0050  
FACSIMILE 502.573.0067**



## **CONTENTS**

	<b><u>Page</u></b>
<b><u>INTRODUCTION</u></b>	
Single Audit Report .....	1
Schedule of Expenditures of Federal Awards .....	1
Schedule of Findings and Questioned Costs .....	1
Summary Schedule of Prior Audit Findings .....	2
Audit Approach .....	2
Status of State Universities .....	2
List Of Abbreviations/Acronyms Used In This Report .....	3
 <b><u>SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS</u></b>	
<b>Schedule of Expenditures of Federal Awards:</b>	
U.S. Office of National Drug Control Policy .....	12
U.S. Department of Agriculture .....	12
U.S. Department of Commerce .....	13
U.S. Department of Defense .....	13
U.S. Department of Housing and Urban Development .....	13
U.S. Department of the Interior .....	14
U.S. Department of Justice .....	14
U.S. Department of Labor .....	16
U.S. Department of Transportation .....	17
U.S. Department of Treasury .....	17
U.S. Appalachian Regional Commission .....	18
U.S. Equal Employment Opportunity Commission .....	18
U.S. General Services Administration .....	18
U.S. National Aeronautics and Space Administration .....	18
U.S. National Foundation on the Arts and the Humanities .....	18
U.S. Department of Veterans Affairs .....	18
U.S. Environmental Protection Agency .....	19
U.S. Department of Energy .....	19
U.S. Department of Education .....	20
U.S. National Archives and Records Administration .....	22
U.S. Election Assistance Commission .....	22
U.S. Department of Health and Human Services .....	22
U.S. Corporation for National and Community Service .....	24
U.S. Social Security Administration .....	25
U.S. Department of Homeland Security .....	25
Other Federal Assistance .....	26
 <b>Notes To The Schedule Of Expenditures Of Federal Awards .....</b>	 <b>27</b>

## **CONTENTS**

(Continued)

**Page**

### **REPORTS ON COMPLIANCE AND ON INTERNAL CONTROL**

Report on Internal Control Over Financial Reporting and  
on Compliance and Other Matters Based on an Audit of Financial Statements  
Performed in Accordance with *Government Auditing Standards* .....40

Report on Compliance With Requirements Applicable to Each Major Program  
and on Internal Control Over Compliance in Accordance With OMB Circular  
A-133 and on the Schedule of Expenditures of Federal Awards .....43

### **SCHEDULE OF FINDINGS AND QUESTIONED COSTS**

**Section 1 - Summary of Auditor's Results** .....48

#### **Section 2 - Financial Statement Findings**

#### **Reportable Conditions Relating to Internal Controls and/or Reportable Instances of Noncompliance**

FINDING 06-CHFS1-1: The Cabinet For Health And Family Services Should  
Strengthen The Security Of System Accounts .....54

FINDING 06-CHFS2-2: The Cabinet For Health And Family Services Should  
Implement Procedures To Ensure Services Are Received Prior To Paying The Full  
Contract Amount .....56

FINDING 06-CHFS3-3: The Cabinet For Health And Family Services Should  
Strengthen Controls Over The Processing Of Vendor Payments.....59

FINDING 06-CHFS4-4: The Cabinet For Health And Family Services Should  
Maintain Adequate Documentation For Contract/Vendor Payments.....66

FINDING 06-CHFS5-5: The Cabinet For Health And Family Services Should  
Strengthen Controls Over The Processing Of Contract Payments .....69

FINDING 06-CHFS6-6: The Cabinet For Health And Family Services Should  
Obtain A SAS 70 Audit.....74

FINDING 06-DEI1-7: The Department Of Employee Insurance Should Ensure All  
Public Funds On Deposit Are Secured .....76

FINDING 06-DOC1-8: The Department Of Corrections Should Strengthen Logical  
Security Procedures Surrounding The ORION Application .....77

FINDING 06-DOC2-9: Department of Corrections Should Strengthen Logical  
Security Procedures Surrounding the VINE Application.....82

## **CONTENTS**

(Continued)

### **Page**

#### **Section 2 - Financial Statement Findings (Continued)**

##### **Reportable Conditions Relating to Internal Controls and/or Reportable Instances of Noncompliance (Continued)**

FINDING 06-DOC3-10: The Department of Corrections Should Strengthen The Security Of System Accounts.....	84
FINDING 06-DWI1-11: The Department For Workforce Investment Should Implement Controls Over Systematic Programs To Ensure Accurate Information Is Available For Closing Package Reporting .....	86
FINDING 06-DWI2-12: The Department For Workforce Investment Should Strengthen Controls To Ensure The Accuracy Of Estimates In The Closing Package.....	90
FINDING 06-DWI3-13: The Department For Workforce Investment Should Implement Controls To Ensure Inactive Accounts Are Written Off Timely For Closing Package Reporting Purposes .....	92
FINDING 06-DWI4-14: The Department For Workforce Investment Should Review Closing Package Information To Ensure Accuracy .....	94
FINDING 06-EDU1-15: The Kentucky Department Of Education's Office Of District Support Services Should Update And Consistently Apply Its Change Management Process .....	96
FINDING 06-EDU2-16: The Kentucky Department Of Education's Office Of District Support Services Should Formalize And Consistently Apply Its Logical Security Policies .....	100
FINDING 06-EDU3-17: The Kentucky Department Of Education's Office Of District Support Services Should Ensure Proper Segregation Of Duties .....	105
FINDING 06-EDU4-18: The Kentucky Department Of Education Should Implement A Comprehensive Information Technology Policy And Ensure Adequate Oversight Authority Is Established .....	107
FINDING 06-EDU5-19: The Kentucky Department Of Education's Office Of Education Technology Should Formalize And Consistently Apply Logical Security Policies For The KETS Network And MUNIS .....	111
FINDING 06-EDU6-20: The Kentucky Department Of Education Should Formalize The Task Order Process And Ensure Business Units Review Contractor Performance.....	115
FINDING 06-FAC1-21: The Finance And Administration Cabinet Should Ensure Contracts Are Being Monitored For Vendor Compliance As Specified In The Contract.....	119

## **CONTENTS**

(Continued)

### **Page**

#### **Section 2 - Financial Statement Findings (Continued)**

##### **Reportable Conditions Relating to Internal Controls and/or Reportable Instances of Noncompliance (Continued)**

FINDING 06-FAC2-22: The Finance And Administration Cabinet's Division Of Fleet Management Should Implement Procedures To Investigate And Communicate All Potential Fleet One Card Discrepancies .....	126
FINDING 06-FAC3-23: The Kentucky State Police Should Improve Procard Controls .....	129
FINDING 06-FAC4-24: The Finance And Administration Cabinet Should Develop And Implement Formal Policy And Procedures To Govern The Security Of The Management Administrative And Reporting System Checkwriter Interface Process.....	131
FINDING 06-FAC5-25: The Office Of Financial Management Should Develop And Implement Policies To Ensure Accounts Are In Compliance With Applicable Laws .....	133
FINDING 06-FAC6-26: The Finance And Administration Cabinet Should Improve Segregation Of Duty Controls .....	136
FINDING 06-FAC7-27: The Finance And Administration Cabinet Should Strengthen Logical Security Procedures Surrounding The Complete Asset Management, Reporting, And Accounting System.....	138
FINDING 06-FAC8-28: The Finance And Administration Cabinet Should Formalize And Consistently Apply The Program Modification Process For The Commonwealth's Cash And Investments System.....	140
FINDING 06-KRSY1-29: The Kentucky Retirement System Should Ensure Internal Controls Are Adequate To Prevent Overrides .....	143
FINDING 06-KST1-30: The Department Of Treasury Should Only Process Wire Transfers For Which Sufficient Funding Exists.....	144
FINDING 06-KST2-31: The Department Of Treasury Should Improve Controls Over The Disbursements And Computer Application Access/Modification Processes.....	147
FINDING 06-KST3-32: The Department Of Treasury Should Develop A Disaster Recovery Plan And Ensure Adequate Documentation Is Stored Off-Site In The Event Of An Emergency Situation .....	151
FINDING 06-KST4-33: The Department Of Treasury Should Reconcile Commonwealth Bank Accounts With MARS In A Timely Manner .....	153

## **CONTENTS**

(Continued)

### **Page**

#### **Section 2 - Financial Statement Findings (Continued)**

##### **Reportable Conditions Relating to Internal Controls and/or Reportable Instances of Noncompliance (Continued)**

FINDING 06-PERS1-34: The Department Of Personnel Should Implement Formal Policies Governing System Access To The Group Health Insurance And Premium Billing And Reconciliation Systems .....	156
FINDING 06-PERS2-35: The Personnel Cabinet Should Adhere To Established Procedures Governing System Access Requests For The Uniform Payroll And Personnel System.....	158
FINDING 06-REV1-36: The Department Of Revenue Should Work With COT To Strengthen Controls Governing Data Processing Of Taxpayer Accounts.....	160
FINDING 06-REV2-37: The Department Of Revenue Should Ensure Access To Production Libraries Is Limited.....	163
FINDING 06-REV3-38: The Department Of Revenue Should Ensure That Formal Program Modification Control Procedures Are Developed And Implemented .....	165
FINDING 06-REV4-39: The Department Of Revenue Should Implement Procedures To Protect Cigarette Tax Stamps.....	167
FINDING 06-REV5-40: The Department Of Revenue And Office Of State Budget Director Should Ensure That Tax Receipts Belonging to County Governments Are Properly Accounted For In The Fiduciary Fund At Year End .....	171
FINDING 06-TC1-41: The Kentucky Transportation Cabinet Should Ensure That Logical Security Procedures Are Consistently Applied For The Trns*port SiteManager System.....	175
FINDING 06-TC2-42: The Kentucky Transportation Cabinet Should Strengthen Internal Controls On Timecards And Implement Proper Segregation Of Duties .....	178
FINDING 06-TC3-43: The Kentucky Transportation Cabinet Should Improve Inventory Procedures For Maintenance Materials .....	180
FINDING 06-TC4-44: The Kentucky Transportation Cabinet Should Implement Reconciliation Procedures To Accurately Account For Infrastructure And Provide Additional Management Oversight .....	186

## **CONTENTS**

(Continued)

### **Page**

### ***Section 3 - Federal Award Findings and Questioned Costs***

#### **Reportable Conditions Relating to Internal Controls and/or Reportable Instances of Noncompliance**

FINDING 06-CHFS2-45: The Cabinet For Health And Family Services Should Implement Procedures To Ensure Services Are Received Prior To Paying The Full Contract Amount .....	190
FINDING 06-CHFS20-46: The Cabinet For Health And Family Services Should Document the Reconciliation Of Quarterly Financial Reports For The Adoption Assistance Program .....	191
FINDING 06-CHFS21-47: The Cabinet For Health And Family Services Should Ensure Policy And Procedures Are Adhered To And Maintain Adequate Records ...	193
FINDING 06-CHFS22-48: The Cabinet For Health And Family Services Should Maintain Proper Supporting Documentation For Case Files .....	197
FINDING 06-CHFS23-49: The Cabinet For Health And Family Services Should Ensure The Jefferson County Child Support Enforcement Office Has Appropriate Approvals For Computer Equipment Purchases .....	200
FINDING 06-CHFS24-50: The Cabinet For Health And Family Services Should Ensure Financial Records For The Administration Of The Child Support Enforcement Program Remain On-Site At The Meade County Attorneys Office At All Times .....	204
FINDING 06-COMM1-51: The Commerce Cabinet Should Ensure The New West Branding Contract's Billing Procedures Are Improved .....	207
FINDING 06-DFWR1-52: The Department Of Fish And Wildlife Resources Should Develop Policies And Procedures Over All Job Duties, Retention Of Accounting Records, And Timely Vendor Payments .....	214
FINDING 06-DFWR2-53: The Department Of Fish And Wildlife Resources Should Make Use Of All State Financial Accounting System Components For Proper Administration Of Federal And State Resources .....	221
FINDING 06-DFWR3-54: The Department Of Fish And Wildlife Resources Should Implement Its Internal Policies And Procedures Over Vendor Invoice Payments .....	223
FINDING 06-DFWR4-55: The Department Of Fish And Wildlife Resources Should Develop Procedures Requiring Cash Draw Downs Within A Reasonable Time Frame, And Requiring Retention Of Supporting Accounting Records .....	225
FINDING 06-DFWR5-56: The Department Of Fish And Wildlife Resources Should Develop Policies And Procedures Over Payroll Errors .....	229



## **CONTENTS**

(Continued)

**Page**

### **Section 3 - Federal Award Findings and Questioned Costs (Continued)**

#### **Reportable Conditions Relating to Internal Controls and/or Reportable Instances of Noncompliance (Continued)**

FINDING 06-DFWR6-57: The Department Of Fish And Wildlife Resources Should Inform Staff Of Receipt Handling Policies And Implement Policies Requiring Retention Of Accounting Records And Supporting Documentation .....	231
FINDING 06-DFWR7-58: The Department Of Fish And Wildlife Resources' Indirect Cost Rates Should Agree To Federally Approved Indirect Cost Rates .....	234
FINDING 06-DMA1-59: The Department Of Military Affairs Should Document Costs Charged To The AIOM Tenant Sub-Project, Including An Approved Cost Allocation Plan For Shared Facility Costs .....	237
FINDING 06-DMA2-60: The Department Of Military Affairs Should Properly Request And Document Grant Extensions .....	243
FINDING 06-DWI8-61: The Department For Workforce Investment Should Ensure Federal Reports Reconcile To The State's Accounting System On A Quarterly Basis By Reporting Category .....	247
FINDING 06-DWI9-62: The Department For Workforce Investment Should Improve Review Procedures Over The Office Of Vocational And Adult Education Consolidated Annual Report Status Of Funds Form .....	254
FINDING 06-JUST1-63: The Justice Cabinet Should Implement Procedures To Ensure Subrecipient A-133 Audits Are Submitted Timely .....	256
FINDING 06-JUST2-64: The Justice Cabinet Should Implement Procedures For The Timely Submission Of Subrecipient Financial Reports .....	258
FINDING 06-KHEAA1-65: The Kentucky Higher Education Assistance Authority Should Send Notices To Borrowers Timely .....	260
FINDING 06-KHEAA2-66: The Kentucky Higher Education Assistance Authority Should Be Suborgated To The Federal Government In A Timely Manner .....	261
FINDING 06-KHESLC1-67: The Kentucky Higher Education Student Loan Corporation Should Closely Monitor Data Transmissions .....	262
FINDING 06-TC12-68: The Transportation Cabinet Should Improve Procedures To Ensure Federal Reports Are Prepared Accurately .....	263
FINDING 06-TC13-69: The Transportation Cabinet Should Improve Procedures To Ensure The Correct Certification Letter For Materials Is Submitted To The Federal Highway Authority .....	265
<b><u>SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS</u></b> .....	268

**CONTENTS**  
(Continued)

**Page**

**APPENDICES**

Appendix 1: List Of State Agencies Audited As Part Of The Statewide Single Audit  
Of The Commonwealth of Kentucky ..... 291

Appendix 2: List Of State Agency Contacts ..... 294

## **INTRODUCTION**

**COMMONWEALTH OF KENTUCKY  
INTRODUCTION  
FOR THE YEAR ENDED JUNE 30, 2006**

**Single Audit Report**

The Auditor of Public Accounts (APA), acting as principal auditor in conjunction with various certified public accounting firms, annually performs a statewide single audit of the Commonwealth of Kentucky.

The APA prepares the Single Audit Report in compliance with Government Auditing Standards, Generally Accepted Government Auditing Standards, and the requirements of Office of Management and Budget (OMB) Circular A-133. The APA, on behalf of the Commonwealth of Kentucky, also prepares a reporting package as required by OMB Circular A-133. The reporting package includes the basic financial statements, Schedule of Expenditures of Federal Awards (SEFA), auditor's reports, Summary Schedule of Prior Audit Findings, and corrective action plans. For the fiscal year ended June 30, 2006 (FY 06), the Single Audit Report is presented in two reports: the Comprehensive Annual Financial Report (CAFR) and the Single Audit Report.

The CAFR, which contains the basic financial statements and the auditor's report thereon, has been issued under separate cover.

The Single Audit Report contains the auditor's reports on internal control over financial reporting and on compliance and other matters, compliance and internal control over compliance with requirements applicable to major federal programs, and the supplementary SEFA. The Single Audit Report also contains the SEFA, Schedule of Findings and Questioned Costs, and the Summary Schedule of Prior Audit Findings.

**Schedule of Expenditures of Federal Awards**

The SEFA is organized by federal grantor. The Catalog of Federal Domestic Assistance (CFDA) numbers and program names are listed under the federal grantor administering the program. The state organizations expending the federal funds are listed beside each CFDA number. The notes to the SEFA provide more detailed information on certain aspects of the expenditures. Clusters of programs are indicated in the schedule by light gray shading.

**Schedule of Findings and Questioned Costs**

The Schedule of Findings and Questioned Costs consists of three (3) sections: Summary of Auditor's Results, Financial Statement Findings, and Federal Award Findings and Questioned Costs. The Summary of Auditor's Results summarizes the type of audit reports issued and lists major programs audited. The Financial Statement Findings lists the audit findings related to the financial statements. The Federal Award Findings and Questioned Costs lists all findings related to federal awards. In both sections, reportable conditions and reportable instances of noncompliance are presented first, then material weaknesses and material instances of noncompliance.

**COMMONWEALTH OF KENTUCKY  
INTRODUCTION  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**Summary Schedule of Prior Audit Findings**

Audit findings reported in the Schedule of Findings and Questioned Costs for FY 05, as well as any previous findings that have not been resolved, are reported in the Summary Schedule of Prior Audit Findings for FY 06.

The Summary Schedule of Prior Audit Findings is organized based on whether the prior year finding was reportable or material. The findings of each classification (reportable and material) are categorized as (1) fully corrected, (2) not corrected or partially corrected, (3) corrective action taken differs significantly from corrective action previously reported, or (4) finding no longer valid or does not warrant further action.

**Audit Approach**

The scope of the statewide single audit for FY 06 included:

- An audit of the basic financial statements and combining and individual fund statements and schedules-nonmajor funds;
- Limited procedures applied to required supplementary information;
- An audit of the SEFA;
- An audit of compliance with the compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* applicable to each major federal program;
- Tests of internal control over compliance in accordance with OMB Circular A-133;
- Tests of compliance with certain provisions of laws, regulations, contracts, and grants; and
- Tests of internal control over financial reporting.

**Status of State Universities**

The Single Audit Act Amendments permit the single audit to cover the entire operations of the entity or include a series of audits covering departments, agencies, or other organizational units expending federal awards. The agencies audited as part of the Statewide Single Audit of the Commonwealth of Kentucky are listed in Appendix 1. The Commonwealth has elected to exclude state universities from the statewide single audit, except as part of the audit of the basic financial statements. Thus, state universities are not included in the accompanying Schedule of Expenditures of Federal Awards and reports on internal control and compliance. It should be noted, however, that state universities are still required to have audits performed in accordance with the provisions of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

**COMMONWEALTH OF KENTUCKY  
INTRODUCTION  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**List Of Abbreviations/Acronyms Used In This Report**

ACH	Automated Clearinghouse
AD	Active Directory
Admin	Administration
AFP	Authorized Funding Plan
AFR	Annual Financial Reporting
AGO	Adjutant General's Office
AGR	Department of Agriculture
AICPA	American Institute of Certified Public Accountants
AIFF	Air Guard Firefighters
AIFS	Air Guard Family Support
AIOM	Air Operations and Maintenance
AMLR	Abandoned Mine Land Reclamation
AMS	Area Message System
ANGI	Air National Guard Relations
AOC	Administrative Office of the Courts
APA	Auditor of Public Accounts
APB	Accounting Principles Board
APD	Advanced Planning Document
AYCM	Army Communications
BBN-IAD	Bolt, Beranek and Newman Interface Access Device
BDC	Backup Domain Controller
CAFR	Comprehensive Annual Financial Report
CAMRA	Complete Asset Management Reporting and Accounting
CAP	Cost Allocation Plan
CARS	Compliance and Receivable System
CCRs	Change Control Requests
CD	Compact Disk
CDC	Center for Disease Control
CED	Cabinet for Economic Development
CFC	Cabinet for Families and Children
CFDA	Catalog of Federal Domestic Assistance
CFR	Code of Federal Regulations
CGMS	Copy Generation Management System
CHFS	Cabinet for Health and Family Services
CHS	Cabinet for Health Services
CICS	Customer Information Control System
CIM	Compaq Information Manager
CIP	Construction in Progress
CIS	Clinical Information Solution
CMS	Cash Management System
COMM	Commerce Cabinet

**COMMONWEALTH OF KENTUCKY  
INTRODUCTION  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**List Of Abbreviations/Acronyms Used In This Report (Continued)**

Commonwealth	Commonwealth of Kentucky
CORR	Department of Corrections
COT	Commonwealth Office of Technology
CPE	Council on Postsecondary Education
CR	Cash Receipt Document
CRS	Customer Request for Services
CSD	Carbonated Soft Drink
CSE	Child Support Enforcement
CSO	Centralized Security Officer
CW	Checkwriter
CWD	Cabinet for Workforce Development
CY	Current Year
C1E	Electronic Payment
DCBS	Department for Community Based Services
DCE	Distributing Computing Endpoint
DCJT	Department of Criminal Justice Training
DCR	Database Change Request
DDM	Distributed Data Management
DED	Deputy Executive Director
DEI	Department of Employee Insurance
DETER	Determining Eligibility Through Extensive Research
DFWR	Department of Fish & Wildlife Resources
DLA	Department for Libraries and Archives
DMA	Department of Military Affairs
DMAR	Department of Military Affairs Regulations
DMH-MRS	Department for Mental Health and Mental Retardation Services
DMS	Department for Medicaid Services
DOC	Department of Corrections
DOD	Department of Defense
DOR	Department of Revenue
DoS	Denial of Service
DPA	Division of Personnel Administration
DRF	Design Request form
DRP	Disaster Recovery Plan
DTS	Department of Technical Service
DVOP	Disabled Veteran's Outreach Program
DWI	Department For Workforce Investment
EDS	Electronic Data Systems Corporation
EDU	Department of Education
EFT	Electronic Fund Transfers

**COMMONWEALTH OF KENTUCKY  
INTRODUCTION  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**List Of Abbreviations/Acronyms Used In This Report (Continued)**

EKOS	Employ Kentucky Operating System
eMARS	Enhanced Management Administrative Reporting System
EMSB	Emergency Medical Standards Board
EPA	Environmental Protection Agency
EPPC	Environmental and Public Protection Cabinet
EPSB	Education Professional Standards Board
F&W	Department of Fish and Wildlife Resources
FAC	Finance and Administration Cabinet
FAD	Family Alternative Diversion
FAP	Finance and Administration Policy
FAS	Financial Analysis System
FASB	Financial Accounting Standards Board
FDIC	Federal Deposit Insurance Corporation
FHWA	Federal Highway Administration
FICA	Federal Insurance Contributions Act
FIFO	First-In First-Out
Finance	Finance and Administration Cabinet
FMB	Financial Management Branch
FSSB	Family Self Sufficiency Branch
FSM	Family Support Memo
FTP	File Transfer Protocol
FY	Fiscal Year
FYE	Fiscal Year End
GAAP	Generally Accepted Accounting Principles
GASB	Governmental Accounting Standards Board
GHI	Group Health Insurance
GIOP	General Inter-ORB Protocol
GMB	Grants Management Branch
GPS	Global Positioning System
GOPM	Governor's Office for Policy and Management
GOLD	Governor's Office for Local Development
GOV	Executive Office of the Governor
HB	House Bill
HR	Human Resources
HRC	Kentucky Commission on Human Rights
HTTP	Hyper Text Transfer Protocol
HTTPS	Hyper Text Transfer Protocol Secure
IAS	Independent Assurance Sample
ID	Identification
IG	Inspector General



**COMMONWEALTH OF KENTUCKY  
INTRODUCTION  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**List Of Abbreviations/Acronyms Used In This Report (Continued)**

IMF	Installation Management Fund
IP	Internet Protocol
IPA	Internal Policy Analyst
IRS	Internal Revenue Service
IIS	Internet Information Server
IT	Information Technology
JAG	Justice Assistance Grants
JUST	Justice and Public Safety Cabinet
JUV	Department of Juvenile Justice
JV	Journal Voucher
KAAAP	Kentucky Access, Accuracy, and Accountability Project
KAMES	Kentucky Automated Management and Eligibility System
KAR	Kentucky Administrative Regulations
KASES	Kentucky Automated Support Enforcement System
KBE	Kentucky Board of Elections
KCA	Kentucky Center for the Arts
KCD	Kentucky Claims Debt Management
KDE	Kentucky Department of Education
KDFWR	Kentucky Department of Fish and Wildlife Restoration
KET	Kentucky Educational Television
KETS	Kentucky Education Technology System
KHCORP	Kentucky Housing Corporation
KHEAA	Kentucky Higher Education Assistance Authority
KHESLC	Kentucky Higher Education Student Loan Corporation
KHS	Kentucky Historical Society
KIA	Kentucky Infrastructure Authority
KMMIS	Kentucky Medicaid Management Information System
KOEP	Kentucky Office of Energy Policy
KOHS	Kentucky Office of Homeland Security
KRS	Kentucky Revised Statutes
KRSY	Kentucky Retirement System
KSP	Kentucky State Police
KST	Kentucky State Treasury
KTAP	Kentucky Transitional Assistance Program
KTC	Kentucky Transportation Cabinet
KVE	Kentucky Vehicle Enforcement
KWP	Kentucky Works Program
KY	Kentucky
KYASAP	Kentucky Agency for Substance Abuse Policy
KYOAG	Kentucky Office of the Attorney General

**COMMONWEALTH OF KENTUCKY  
INTRODUCTION  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**List Of Abbreviations/Acronyms Used In This Report (Continued)**

KYTC	Kentucky Transportation Cabinet
LAN	Local Area Network
LaRS	Lender Reporting System
LHD	Local Health Department
LLC	Limited Liability Corporation
LRC	Legislative Research Commission
LSA	Local Security Authority
LTC	Long Term Care
LWIA	Local Workforce Investment Areas
MARS	Management Administrative Reporting System
MAP	Management Advisory Procedures
MCA	Master Cooperative Agreement
MHMR	Mental Health Mental Retardation
MIL	Department for Military Affairs
MISCR	Medicaid Inter-Office System Change Request
MIXERS	Miscellaneous Taxes Registration System
MMIS	Medicaid Management Information System
MOD	Modification
MRDB	Management Reporting Database
MUNIS	Municipal Information System(s)
MVU	Motor Vehicle Usage
NA	Not Applicable
NBI	National Bridge Inventory
NEO	Internet Entity Object
NetBIOS	Network Basic Input Output System
NGB	National Guard Building
NGR	National Guard Regulations
NSC	National Student Clearinghouse
NTP	Network Time Protocol
NT	New Technology
OAD	Office of Application Development
OAG	Office of the Attorney General
OCO	Office of Contract Oversight
ODCP	Office of Drug Control Policy
ODSS	Office of District Support Services
OET	Office of Employment Training
OET	Office of Education Technology
OFM	Office of Financial Management
OIAS	Office of Internal Administration and Support
OIG	Office of Inspector General

**COMMONWEALTH OF KENTUCKY  
INTRODUCTION  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**List Of Abbreviations/Acronyms Used In This Report (Continued)**

OIT	Office of Information Technology
OMB	Office of Management and Budget
OMPS	Office of Material and Procurement Services
OMS	Operations Management System
ORION	Offender Records Information Operations Network
OS	Operating System
OSBD	Office of the State Budget Director
OSI	Offender Security Information
OVAE	Office of Vocational and Adult Education
OVAECAR	Office of Vocational and Adult Education Consolidated Annual Report
PARKS	Department of Parks
PAS	Public Assistance System
PB&R	Premium Billing and Reconciliation
PCG	Public Consulting Group
PCR	Program Change Request
PD	Procurement Desktop
PDC	Primary Domain Controller
PERS	Department of Personnel
Personnel	Personnel Cabinet
ProCard	Procurement Card
PUBAD	Department of Public Advocacy
PV	Payment Voucher
PWB	Project Workbook
PY	Prior Year
R&D	Research and Development
RACF	Resource Access Control Facility
RCW	Record of Control Weakness
RDB	Relational Data Base
REV	Department of Revenue
Revenue	Department of Revenue
RFP	Request for Proposal
RHP	Replacement Housing Payment
RMCP	Remote Mail Checking Protocol
RMI	Remote Method Invocation
RPC	Remote Procedure Call
RTMC-SC	Radio Technical Commission For Maritime Services
RTMP	Real Time Management Protocol
SA	Server Administrator
SARF	Server Access Request Form

**COMMONWEALTH OF KENTUCKY  
INTRODUCTION  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**List Of Abbreviations/Acronyms Used In This Report (Continued)**

SAS	Statistical Analysis System
SAS	Statement on Auditing Standards
SB	Senate Bill
SDC	Systems Development Services
SDLC	System Development Life Cycle
SEEK	Support Education Excellence in Kentucky
SEFA	Schedule of Expenditures of Federal Awards
SF	Short Form
SFY	State Fiscal Year
SLSS	Student Loan Servicing System
SMB	System Management Branch
SMUX	Simple Network Management Protocol Multiplex
SNMP	Simple Network Management Protocol
SP	Service Pack
SQL	Standard Query Language
SSH	Secured Socket Layer
SSL	Secure Socket Layer
SSN	Social Security Numbers
SSWAK	Statewide Single Audit of Kentucky
STEP	System Tracking Employability Program
TANF	Temporary Assistance for Needy Families
TC	Transportation Cabinet
TCP	Transmission Control Protocol
TIER	Tier Technologies
TIPS	Transportation Information Payroll System
TLS	Transport Layer Security
TPS	Technology Planning Council
UGIRLT	Utilities Gross receipts License Tax
UK	University of Kentucky
UPS	Unified Prosecutorial System
UPPS	Uniform Payroll and Personnel System
U.S.	United States
USDA	United States Department of Agriculture
USDOJ	United States Department of Justice
USDOT	United States Department of Transportation
USPFO	United States Property and Fiscal Officer
VA	Department of Veterans' Affairs
VAWA	Violence Against Women Formula Grants
VINE	Victim Information and Notification Everyday
VOCA	Crime Victim Assistance Grant

**COMMONWEALTH OF KENTUCKY  
INTRODUCTION  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**List Of Abbreviations/Acronyms Used In This Report (Continued)**

WIA	Workforce Investment Act
WIN	Work Incentive
WMD	Weapons of Mass Destruction
WT	Wire Transfer
XSS	Cross Site Scripting

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**

**COMMONWEALTH OF KENTUCKY**  
**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**  
**FEDERAL ASSISTANCE PROGRAMS**  
**FOR THE YEAR ENDED JUNE 30, 2006**

CFDA	Program Title	State Agency	Expenditures		Provided to Subrecipient
			Cash	Noncash	
<b><u>U.S. Office of National Drug Control Policy</u></b>					
<b>Direct Program:</b>					
07.NA(1)	HIDTA Program	KSP	\$ 900,172	\$	\$
07.NA(2)	Other Federal Assistance	KVE	20,428		
<b>Total U.S. Office of National Drug Control Policy</b>			<b>\$ 920,600</b>	<b>\$</b>	<b>\$</b>
<b><u>U.S. Department of Agriculture</u></b>					
<b>Direct Programs:</b>					
10.025	Plant and Animal Disease, Pest Control, and Animal Care	AGR	\$ 723,093	\$	\$
		F&W	43,069		
10.028	Wildlife Services (Note 9)	F&W	248		
10.069	Conservation Reserve Program	EPPC	27,938		
10.153	Market News (Note 14)	AGR			
10.156	Federal- State Marketing Improvement Program	AGR	94,134		
10.163	Market Protection and Promotion	AGR	77,927		
<b>Food Stamp Cluster:</b>					
10.551	Food Stamps (Note 2) (Note 13)	CHFS		640,370,080	
10.561	State Administrative Matching Grants for Food Stamp Program (Note 2) (Note 14)	CHFS OAG	31,541,989		258,263
<b>Child Nutrition Cluster:</b>					
10.553	School Breakfast Program (Note 2)	EDU	41,729,192		41,621,569
		JUV	424,030		
10.555	National School Lunch Program (Note 2)	EDU	121,606,547		121,410,126
		JUV	653,769		
10.556	Special Milk Program for Children (Note 2)	EDU	73,945		47,772
10.559	Summer Food Service Program for Children (Note 2)	EDU	8,102,061		7,911,208
10.550	Food Donation (Note 13)	AGR		16,118,608	
10.557	Special Supplemental Nutrition Program for Women, Infants, and Children (Note 2)	CHFS	105,067,616		18,563,666
10.558	Child and Adult Care Food Program (Note 2)	EDU	25,966,265		25,833,683
10.560	State Administrative Expenses for Child Nutrition	EDU	2,166,042		
		AGR	193,873		
10.565	Commodity Supplemental Food Program (Note 13) (Note 16)	AGR	817,899	5,016,772	
<b>Emergency Food Assistance Cluster:</b>					
10.568	Emergency Food Assistance Program (Administrative Costs)	AGR	936,253		
10.569	Emergency Food Assistance Program (Food Commodities) (Note 13)	AGR		4,457,261	
10.572	WIC Farmers' Market Nutrition Program (FMNP)	AGR	288,271		
10.576	Senior Farmers Market Nutrition Program	AGR	284,997		
10.652	Forestry Research	EPPC	62,188		
10.664	Cooperative Forestry Assistance (Note 13)	EPPC	2,680,879	155,427	889,302
10.672	Rural Development, Forestry, and Communities	EPPC	87,868		
10.766	Community Facilities Loans and Grants (Note 2) (Note 3e) (Note 13)	KHCORP		66,327,317	
10.769	Rural Business Enterprise Grants	AGR	5,335		
10.771	Rural Cooperative Development Grants (Note 14)	AGR			
10.861	Public Television Station Digital Transition Grant Program	KET	15,600		

See accompanying Notes to the Schedule of Expenditures of Federal Awards

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FEDERAL ASSISTANCE PROGRAMS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

CFDA	Program Title	State Agency	Expenditures		Provided to Subrecipient
			Cash	Noncash	
U.S. Department of Agriculture (Continued)					
Direct Programs (Continued):					
10.902	Soil and Water Conservation	EPPC	1,252,127		30,000
		F&W	277,556		
10.912	Environmental Quality Incentives Program (Note 14)	EPPC			
10.914	Wildlife Habitat Incentive Program (Note 13)	F&W		17,499	
10.NA(1)	Rural Rehabilitation Student Loan Program (Note 3a)	AGR	111,754		
Total U.S. Department of Agriculture			\$ 345,312,465	\$ 732,462,964	\$ 216,565,589
U.S. Department of Commerce					
Direct Programs:					
Public Works and Economic Development Cluster:					
11.307	Economic Adjustment Assistance (Note 3b)	GOLD	\$ 49,128	\$	\$
11.450	Automated Flood Warning Systems (AFWS)	MIL	40,216		
11.469	Congressionally Identified Awards and Projects	PARKS	18,250		
		DWI	3,087		
11.550	Public Telecommunications Facilities Planning and Construction	KET	573,836		
Total U.S. Department of Commerce			\$ 684,517	\$	\$ 0
U.S. Department of Defense					
Direct Programs:					
12.002	Procurement Technical Assistance For Business Firms	CED	\$ 135,847	\$	\$
12.113	State Memorandum of Agreement Program for the Reimbursement of Technical Services	EPPC	256,837		
12.400	Military Construction, National Guard	MIL	7,408,421		
12.401	National Guard Military Operations and Maintenance (O & M) Projects	MIL	11,353,304		
12.404	National Guard Civilian Youth Opportunities	MIL	1,848,571		
12.NA(1)	Chemical Demilitarization and Remediation Activity for Hazardous Waste Activities at Chemical Demilitarization Facilities	EPPC	200,141		9,071
12.NA(2)	Monitoring of Wildlife	F&W	21,689		
12.NA(3)	Teacher and Teacher's Aide Placement Assistance Program	EPSB	73,972		
Total U.S. Department of Defense			\$ 21,298,782	\$	\$ 9,071
U.S. Department of Housing and Urban Development					
Direct Programs:					
14.117	Mortgage Insurance - Homes (Note 2) (Note 3e) (Note 13)	KHCORP	\$	\$ 169,038,027	\$
14.169	Housing Counseling Assistance Program	KHCORP	330,936		
Section 8 Project-Based Cluster:					
14.182	Lower Income Housing Assistance Program-Section 8 New Construction/Substantial Rehabilitation (Note 2)	KHCORP	89,902,822		
14.856	Lower Income Housing Assistance Program-Section 8 Moderate Rehabilitation (Note 2)	KHCORP	72,722		
14.228	Community Development Block Grants/State's Program (Note 2) (Note 10)	GOLD HRC	35,621,964 230		34,156,414
14.231	Emergency Shelter Grants Program	KHCORP	1,424,837		1,378,649
14.235	Supportive Housing Program	KHCORP	4,344,523		4,223,838
14.238	Shelter Plus Care	KHCORP	278,918		173,565

See accompanying Notes to the Schedule of Expenditures of Federal Awards



**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FEDERAL ASSISTANCE PROGRAMS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

CFDA	Program Title	State Agency	Expenditures		Provided to Subrecipient
			Cash	Noncash	
U.S. Department of Housing and Urban Development (Continued)					
Direct Programs (Continued):					
14.239	HOME Investment Partnerships Program	KHCORP	19,989,165		12,954,742
14.241	Housing Opportunities for Persons with AIDS	KHCORP	384,715		364,332
14.401	Fair Housing Assistance Program-State and Local	HRC	179,712		
14.409	Fair Housing Initiatives Program (FHIP) Education and Outreach Initiative (Note 14)	HRC			
14.871	Section 8 Housing Choice Vouchers (Note 2)	KHCORP	20,558,951		
14.NA(1)	Katrina Disaster Housing Assistance Payments/Disaster Voucher Payment	KHCORP	32,726		
Total U.S. Department of Housing and Urban Development			\$ 173,122,221	\$ 169,038,027	\$ 53,251,540
U.S. Department of the Interior					
Direct Programs:					
15.250	Regulation of Surface Coal Mining and Surface Effects of Underground Coal Mining (Note 13)	EPPC	\$ 11,556,756	\$ 33,589	\$ 8,261
15.252	Abandoned Mine Land Reclamation (AMLR) Program	EPPC	15,784,365		4,590,496
Fish and Wildlife Cluster:					
15.605	Sport Fish Restoration (Note 9)	F&W	3,672,926		
15.611	Wildlife Restoration (Note 11)	F&W	3,537,964		
15.615	Cooperative Endangered Species Conservation Fund (Note 9)	F&W	113,405		
		EPPC	38,486		1,696
15.616	Clean Vessel Act	F&W	43,032		
15.618	Administrative Grants for Federal Aid in Sport Fish and Wildlife Restoration (Note 14)	F&W			
15.622	Sportfishing and Boating Safety Act	F&W	100,000		
15.623	North American Wetlands Conservation Fund (Note 14)	EPPC			
15.625	Wildlife Conservation and Restoration (Note 14)	F&W			
15.632	Conservation Grants Private Stewardship for Imperiled Species	F&W	58,833		
		EPPC	381		
15.633	Landowner Incentive	F&W	541,497		
		EPPC	290,535		
15.634	State Wildlife Grants (Note 9)	F&W	322,145		
15.808	U.S. Geological Survey-Research and Data Collection (Note 14)	COT	30,000		
		F&W			
15.904	Historic Preservation Fund Grants-In-Aid	KHC	627,543		81,296
15.916	Outdoor Recreation-Acquisition, Development & Planning (Note 7) (Note 14)	GOLD	1,348,970		1,348,970
		PARKS			
15.NA(1)	National Fish and Wildlife Foundation-Restoration of Elk Habitat in Kentucky (Note 14)	F&W			
Total U.S. Department of the Interior			\$ 38,066,838	\$ 33,589	\$ 6,030,719
U.S. Department of Justice					
Direct Programs:					
16.003	Law Enforcement Assistance-Narcotics and Dangerous Drugs Technical Laboratory Publications (Note 14)	COT	\$	\$	\$
16.203	Comprehensive Approaches to Sex Offender Management Discretionary Grant	CORR	9,014		

See accompanying Notes to the Schedule of Expenditures of Federal Awards

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FEDERAL ASSISTANCE PROGRAMS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

CFDA	Program Title	State Agency	Expenditures		Provided to Subrecipient
			Cash	Noncash	
U.S. Department of Justice (Continued)					
Direct Programs (Continued):					
16.523	Juvenile Accountability Incentive Block Grants	JUV	1,074,084		129,566
		UPS	45,833		
		AOC	43,638		
		PUBAD	41,264		
16.540	Juvenile Justice and Delinquency Prevention-Allocation to States	JUV	812,154		784,283
16.541	Developing, Testing and Demonstrating Promising New Programs Part E	AOC	7,495		
16.542	Part D-Research, Evaluation, Technical Assistance and Training (Note 14)	AOC			
16.543	Missing Children's Assistance	KSP	259,493		
16.548	Title V-Delinquency Prevention Program	JUV	260,498		252,847
16.549	Part E-State Challenge Activities	JUV	58,511		58,511
16.550	State Justice Statistics Program for Statistical Analysis Centers	JUST	18,482		
16.554	National Criminal History Improvement Program (NCHIP) (Note 14)	KSP	725,999		
		JUST			
16.560	National Institute of Justice Research, Evaluation, and Development Project Grants	KSP	535,164		
		JUST	25,125		
16.564	Crime Laboratory Improvement-Combined Offender DNA Index System Backlog Reduction (Note 14)	KSP			
16.575	Crime Victim Assistance	JUST	4,331,918		4,220,116
		UPS	299,389		
16.576	Crime Victim Compensation	EPPC	491,835		
16.579	Edward Byrne Memorial Formula Grant Program (Note 14)	JUST	2,684,924		2,449,403
		KSP	312,024		
		AOC	198,553		
		CORR	145,935		
		UPS	36,809		
		JUV	12,803		12,803
		PUBAD			
16.580	Edward Byrne Memorial State and Local Law Enforcement Assistance Discretionary Grants Program	AOC	887,960		
16.585	Drug Court Discretionary Grant Program (Note 9)	AOC	854,821		
16.586	Violent Offender Incarceration and Truth in Sentencing Incentive Grants	CORR	2,000,739		
		JUV	390,363		360,371
		JUST	19,521		
16.588	Violence Against Women Formula Grants	JUST	1,454,677		1,413,156
		UPS	190,280		
		OAG	65,127		
		CHFS	10,018		
16.589	Rural Domestic Violence and Child Victimization Enforcement Grant Program	JUST	178,623		
16.592	Local Law Enforcement Block Grants Program	KVE	150,000		
		KSP	71,257		
		JUST	18,499		2,939
		PARKS	6,547		
16.593	Residential Substance Abuse Treatment for State Prisoners (Note 14)	CORR	504,155		
		JUST			
16.606	State Criminal Alien Assistance Program	CORR	49,350		
16.607	Bulletproof Vest Partnership Program (Note 14)	CORR	25,650		
		KSP	8,003		
		AOC	3,880		
		JUST			
16.609	Community Prosecution and Project Safe Neighborhoods	UPS	36,664		
16.610	Regional Information Sharing Systems	COT	339,518		

See accompanying Notes to the Schedule of Expenditures of Federal Awards

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FEDERAL ASSISTANCE PROGRAMS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

CFDA	Program Title	State Agency	Expenditures		Provided to Subrecipient
			Cash	Noncash	
U.S. Department of Justice (Continued)					
Direct Programs (Continued):					
16.710	Public Safety Partnership and Community Policing Grants (Note 12)	KSP	242,730		
		OAG	122,753		
16.712	Police Corps	DCJT	272,223		
16.727	Enforcing Underage Drinking Laws Program	KSP	282,975		94,622
16.728	Drug Prevention Program (Note 14)	TC			
16.738	Edward Byrne Memorial Justice Assistance Grant Program	KSP	1,040,132		
		JUST	1,006,307		901,045
		AOC	49,329		
		KVE	39,534		
16.NA(1)	Drug Enforcement Administration	KSP	1,034,511		
16.NA(2)	Federal Bureau of Investigation	KSP	81,828		
16.NA(3)	Federal Methamphetamine Initiative	KSP	26,373		
16.NA(4)	Bureau of Alcohol, Tobacco, Fireamrs & Explosives (ATF) Program	KSP	24,196		
16.NA(5)	Prescription Drug Monitoring Program	CHFS	175,284		
Total U.S. Department of Justice			\$ 24,094,771	\$	\$ 10,679,662
U.S. Department of Labor					
Direct Programs:					
17.002	Labor Force Statistics	DWI	\$ 1,068,344	\$	\$
17.005	Compensation and Working Conditions	EPPC	156,302		
Employment Services Cluster:					
17.207	Employment Service/Wagner-Peyser Funded Activities	DWI	10,302,834		7,722
17.801	Disabled Veterans' Outreach Program (DVOP)	DWI	773,531		
17.804	Local Veterans' Employment Representative Program	DWI	1,437,647		
17.225	Unemployment Insurance (Note 2) (Note 5)	DWI	389,814,259		14,135
17.235	Senior Community Service Employment Program	CHFS	1,606,971		1,570,671
17.245	Trade Adjustment Assistance (Note 2)	DWI	27,288,117		4,914,655
Workforce Investment Act Cluster:					
17.258	WIA Adult Program (Note 2)	DWI	15,883,222		15,734,522
17.259	WIA Youth Activities (Note 2)	DWI	13,133,041		11,986,317
		MIL	240,480		
		EDU	107,790		107,820
17.260	WIA Dislocated Workers (Note 2)	DWI	19,670,335		18,827,911
		EDU	641,825		590,831
17.261	WIA Pilots, Demonstrations, and Research Projects	DWI	116,405		116,405
17.267	Incentive Grants-WIA Section 503 (Note 14)	DWI	831,520		637,649
		CPE	372,054		
		MIL			
17.272	Permanent Labor Certification for Foreign Workers	DWI	225,282		
17.503	Occupational Safety and Health-State Program	EPPC	3,167,392		25,832
17.504	Consultation Agreements (Note 14)	EPPC			
17.600	Mine Health and Safety Grants	EPPC	697,670		
17.601	Mine Health and Safety Counseling and Technical Assistance	EPPC	253,973		
Total U.S. Department of Labor			\$ 487,788,994	\$	\$ 54,534,470

See accompanying Notes to the Schedule of Expenditures of Federal Awards

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FEDERAL ASSISTANCE PROGRAMS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

CFDA	Program Title	State Agency	Expenditures		Provided to Subrecipient
			Cash	Noncash	
U.S. Department of Transportation					
Direct Programs:					
Air Transportation Cluster:					
20.106	Airport Improvement Program	MIL	\$ 1,819,760	\$	\$
		TC	11,945		
Highway Planning and Construction Cluster:					
20.205	Highway Planning and Construction (Note 2) (Note 6)	TC	521,488,118		36,682
		PARKS	351,982		
20.218	National Motor Carrier Safety (Note 14)	KVE	3,533,217		76,019
		KSP	451,291		
		TC			
20.219	Recreational Trails Program (Note 7)	GOLD	640,559		508,223
		PARKS	15,930		
20.232	Commercial Driver License State Programs	TC	285,000		
20.505	Federal Transit-Metropolitan Planning Grants	TC	463,953		422,696
Federal Transit Cluster:					
20.500	Federal Transit-Capital Investment Grants	TC	7,747,117		7,747,117
20.507	Federal Transit-Formula Grants	TC	490,828		490,828
20.509	Formula Grants for Other Than Urbanized Areas	TC	7,183,425		6,668,841
20.513	Capital Assistance Program for Elderly Persons and Persons with Disabilities	TC	1,523,636		1,523,636
Highway Safety Cluster:					
20.600	State and Community Highway Safety	KSP	5,031,366		1,529,275
		AOC	55,936		
		KVE	13,885		
		DCJT	8,270		
20.601	Alcohol Traffic Safety and Drunk Driving Prevention Incentive Grants	TC	88,699		
20.604	Safety Incentive Grants for Use of Seatbelts	KSP	183,201		178,969
		KVE	23,499		
20.605	Safety Incentives to Prevent Operation of Motor Vehicles by Intoxicated Persons	TC	1,121,948		
		KSP	816,926		
20.700	Pipeline Safety	EPPC	212,717		
20.703	Interagency Hazardous Materials Public Sector Training and Planning Grants	MIL	103,657		
Total U.S. Department of Transportation			\$ 553,666,865	\$	\$ 19,182,286
U.S. Department of Treasury					
Direct Programs:					
21.NA(1)	Internal Revenue Service	KSP	\$ 17,455	\$	\$
Total U.S. Department of Treasury			\$ 17,455	\$	\$

See accompanying Notes to the Schedule of Expenditures of Federal Awards

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FEDERAL ASSISTANCE PROGRAMS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

CFDA	Program Title	State Agency	Expenditures		Provided to Subrecipient
			Cash	Noncash	
<b><u>U.S. Appalachian Regional Commission</u></b>					
<b>Direct Programs:</b>					
23.002	Appalachian Area Development	KHCORP	\$ 302,294	\$	\$ 302,294
		GOLD	32,470		32,470
23.011	Appalachian Research, Technical Assistance, and Demonstration Projects	GOLD	795,590		795,590
		FAC	229,398		
<b>Total U.S. Appalachian Regional Commission</b>			<b>\$ 1,359,752</b>	<b>\$</b>	<b>\$ 1,130,354</b>
<b><u>U.S. Equal Employment Opportunity Commission</u></b>					
<b>Direct Programs:</b>					
30.002	Employment Discrimination-State and Local Fair Employment Practices Agency Contracts	HRC	\$ 209,940	\$	\$
<b>Total U.S. Equal Employment Opportunity Commission</b>			<b>\$ 209,940</b>	<b>\$</b>	<b>\$</b>
<b><u>U.S. General Services Administration</u></b>					
<b>Direct Programs:</b>					
39.003	Donation of Federal Surplus Personal Property (Note 13)	FAC	\$	\$ 675,066	\$
39.011	Election Reform Payments (Note 18)	KBE	577,100		325,428
<b>Total U.S. General Services Administration</b>			<b>\$ 577,100</b>	<b>\$ 675,066</b>	<b>\$ 325,428</b>
<b><u>U.S. National Aeronautics and Space Administration</u></b>					
<b>Direct Programs:</b>					
43.002	Technology Transfer	COT	\$ 667,081	\$	\$
<b>Total U.S. National Aeronautics and Space Administration</b>			<b>\$ 667,081</b>	<b>\$</b>	<b>\$</b>
<b><u>U.S. National Foundation on the Arts and the Humanities</u></b>					
<b>Direct Programs:</b>					
45.024	Promotion of the Arts-Grants to Organizations and Individuals (Note 14)	KCA	\$ 33,127	\$	\$
		KET			
		KAC	8,000		
45.025	Promotion of the Arts-Partnership Agreements	KAC	649,908		177,204
45.026	Promotion of the Arts-Leadership Initiatives (Note 14)	KHS	1,779		
		KAC			
45.129	Promotion of the Humanities-Federal/State Partnership	KHS	982		
45.130	Promotion of the Humanities-Challenge Grants	KET	200,000		
45.310	Grants to States	DLA	2,419,392		873,842
<b>Total U.S. National Foundation on the Arts and Humanities</b>			<b>\$ 3,313,188</b>	<b>\$</b>	<b>\$ 1,051,046</b>
<b><u>U.S. Department of Veterans Affairs</u></b>					
<b>Direct Programs:</b>					
64.005	Grants to States for Construction of State Home Facilities	VA	\$ 680,082	\$	\$
64.114	Veterans Housing-Guaranteed and Insured Loans (Note 2) (Note 3e) (Note 13)	KHCORP		17,168,120	
64.203	State Cemetery Grants	VA	1,870,116		
<b>Total U.S. Department of Veterans Affairs</b>			<b>\$ 2,550,198</b>	<b>\$ 17,168,120</b>	<b>\$</b>

See accompanying Notes to the Schedule of Expenditures of Federal Awards

**COMMONWEALTH OF KENTUCKY**  
**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**  
**FEDERAL ASSISTANCE PROGRAMS**  
**FOR THE YEAR ENDED JUNE 30, 2006**  
**(CONTINUED)**

CFDA	Program Title	State Agency	Expenditures		Provided to Subrecipient
			Cash	Noncash	
<b><u>U.S. Environmental Protection Agency</u></b>					
<b>Direct Programs:</b>					
66.001	Air Pollution Control Program Support	EPPC	\$ 1,356,725	\$	\$
66.032	State Indoor Radon Grants	CHFS	466,806		355,225
66.034	Surveys, Studies, Investigations, Demonstrations and Special Purpose Activities Relating to the Clean Air Act (Note 13)	EPPC	746,292	17,088	
66.418	Construction Grants for Wastewater Treatment Works	EPPC	385,544		
66.419	Water Pollution Control State, Interstate, and Tribal Program Support (Note 13)	EPPC	2,156,614	19,960	190,263
66.432	State Public Water System Supervision	EPPC	854,078		
66.436	Surveys, Studies, Investigations, Demonstrations, and Training Grants and Cooperative Agreements-Section 104(B)(3) of the Clean Water Act	EPPC	2,637		
66.454	Water Quality Management Planning	EPPC	209,191		199,326
66.458	Capitalization Grants for Clean Water State Revolving Funds (Note 2) (Note 3d)	KIA	18,740,782		18,740,782
		EPPC	231,759		
66.460	Nonpoint Source Implementation Grants	EPPC	3,217,985		1,734,790
66.461	Regional Wetland Program Development Grants (Note 14)	EPPC	64,771		
		F&W			
66.463	Water Quality Cooperative Agreements	EPPC	47,712		47,354
66.467	Wastewater Operator Training Grant Program (Technical Assistance)	EPPC	44,236		
66.468	Capitalization Grants for Drinking Water State Revolving Funds (Note 2) (Note 3d)	KIA	5,898,077		5,898,077
		EPPC	1,603,704		
66.470	Hardship Grants Program for Rural Communities	EPPC	218,239		218,239
66.471	State Grants to Reimburse Operators of Small Water Systems for Training and Certification Costs	EPPC	46,695		
66.474	Water Protection Grants to the States	EPPC	50,099		
66.606	Surveys, Studies, Investigations and Special Purpose Grants (Note 13)	EPPC		220,500	
66.608	Environmental Information Exchange Network Grant Program and Related Assistance	EPPC	543,027		
		COT	137,947		
66.700	Consolidated Pesticide Enforcement Cooperative Agreements	AGR	674,328		
66.701	Toxic Substances Compliance Monitoring Cooperative Agreements	EPPC	71,853		13,191
66.707	TSCA Title IV State Lead Grants Certification of Lead-Based Paint Professionals	CHFS	281,721		
66.708	Pollution Prevention Grants Program	EPPC	19,640		
66.801	Hazardous Waste Management State Program Support	EPPC	2,439,144		
66.802	Superfund State, Political Subdivision, and Indian Tribe Site-Specific Cooperative Agreements	EPPC	28,343		
66.804	State and Tribal Underground Storage Tanks Program	EPPC	186,675		
66.805	Leaking Underground Storage Tank Trust Fund Program	EPPC	1,620,923		
66.808	Solid Waste Management Assistance Grants	EPPC	5,017		
66.809	Superfund State and Indian Tribe Core Program-Cooperative Agreements	EPPC	79,779		
66.817	State and Tribal Response Program Grants	EPPC	433,208		
66.940	Environmental Policy and State Innovation Grants (Note 14)	EPPC			
<b>Total U.S. Environmental Protection Agency</b>			<u>\$ 42,863,551</u>	<u>\$ 257,548</u>	<u>\$ 27,397,247</u>
<b><u>U.S. Department of Energy</u></b>					
<b>Direct Programs:</b>					
81.039	Nation Energy Information Center (Note 4) (Note 14)	KOEP	\$ 7,860	\$	\$
		EPPC			
81.041	State Energy Program (Note 4) (Note 14)	KOEP	419,719		189,135
		EPPC			
81.042	Weatherization Assistance for Low-Income Persons	CHFS	4,607,992		3,630,519
81.086	Conservation Research and Development (Note 14)	EPPC			

See accompanying Notes to the Schedule of Expenditures of Federal Awards

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FEDERAL ASSISTANCE PROGRAMS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

CFDA	Program Title	State Agency	Expenditures		Provided to Subrecipient
			Cash	Noncash	
<b>U.S. Department of Energy (Continued)</b>					
<b>Direct Programs (Continued):</b>					
81.117	Energy Efficiency and Renewable Energy Information Dissemination, Outreach, Training and Technical Analysis/Assistance (Note 4) (Note 14)	KOEP EPPC	54,218		
81.119	State Energy Program Special Projects (Note 4) (Note 14)	KOEP EPPC	106,850		106,850
81.502	Paducah Gaseous Diffusion Plant Environmental Monitoring and Oversight	EPPC CHFS	1,140,892 400,331		202,824 199,415
<b>Total U.S. Department of Energy</b>			<u>\$ 6,737,862</u>	<u>\$</u>	<u>\$ 4,328,743</u>
<b>U.S. Department of Education</b>					
<b>Direct Programs:</b>					
84.002	Adult Education-State Grant Program (Note 2)	CPE MIL	\$ 9,101,943 139,380	\$	\$ 7,914,356
84.010	Title I Grants to Local Educational Agencies (Note 2)	EDU	185,351,725		183,324,053
84.011	Migrant Education - State Grant Program	EDU	6,679,176		6,526,430
84.013	Title I Program for Neglected and Delinquent Children	JUV CORR EDU	695,523 14,727 12,067		516,621
<b>Special Education Cluster:</b>					
84.027	Special Education - Grants to States (Note 2)	EDU	149,250,349		145,740,425
84.173	Special Education - Preschool Grants (Note 2)	EDU	9,860,785		9,433,793
<b>Student Financial Assistance Programs Cluster:</b>					
84.032	Federal Family Education Loans (Note 2) (Note 3c) (Note 15)	KHEAA KHESLC	72,694,217 64,956,979		
84.048	Vocational Education-Basic Grants to States	DWI EDU	11,924,154 6,403,883		11,024,423 6,103,298
84.069	Leveraging Educational Assistance Partnership	KHEAA	977,219		
84.116	Fund for the Improvement of Postsecondary Education	CPE	59,708		
84.126	Rehabilitation Services-Vocational Rehabilitation Grants to States (Note 2) (Note 9)	DWI	45,482,786		701,998
84.128	Rehabilitation Services-Service Projects	DWI	72,648		72,568
84.133	National Institute on Disability and Rehabilitation Research	CPE	360		
84.161	Rehabilitation Services-Client Assistance Program	DWI	169,256		
84.169	Independent Living-State Grants	DWI	313,420		
84.177	Rehabilitation Services-Independent Living Services for Older Individuals Who are Blind	DWI	396,354		
84.181	Special Education-Grants for Infants and Families with Disabilities	CHFS	4,281,815		
84.184	Safe and Drug-Free Schools and Communities-National Programs	EDU	271,324		173,269
84.185	Byrd Honors Scholarships (Note 17) (Note 14)	KHEAA EDU	491,866		
84.186	Safe and Drug-Free Schools and Communities-State Grants	EDU CHFS	4,600,367 1,633,013		4,478,822 1,633,013
84.187	Supported Employment Services for Individuals with Severe Disabilities	DWI	385,472		
84.196	Education for Homeless Children and Youth	EDU	628,777		697,349
84.213	Even Start - State Educational Agencies	EDU	3,226,662		2,959,859
84.215	Fund for the Improvement of Education (Note 12)	KHS EDU	49,296 2,342		

See accompanying Notes to the Schedule of Expenditures of Federal Awards

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FEDERAL ASSISTANCE PROGRAMS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

CFDA	Program Title	State Agency	Expenditures		Provided to Subrecipient
			Cash	Noncash	
U.S. Department of Education (Continued)					
Direct Programs (Continued):					
84.224	Assistive Technology	DWI	431,858		257,932
84.240	Program of Protection and Advocacy of Individual Rights	PUBAD	160,647		
84.243	Tech-Prep Education	DWI	1,914,357		255,524
84.265	Rehabilitation Training-State Vocational Rehabilitation Unit In-Service Training	DWI	149,626		9,413
84.281	Eisenhower Professional Development State Grants (Note 14)	EDU			
84.287	Twenty-First Century Community Learning Centers	EDU	9,488,118		9,421,108
84.298	State Grants for Innovative Programs	EDU	3,429,682		3,148,550
		KCA	25,900		
84.318	Education Technology State Grants	EDU	7,730,824		7,366,339
84.323	Special Education-State Personnel Development	EDU	1,425,322		1,425,322
84.326	Special Education - Technical Assistance and Dissemination to Improve Services and Results for Children with Disabilities	EDU	131,564		163,404
84.327	Special Education - Technology and Media Services for Individuals with Disabilities	EDU	133,560		155,088
84.330	Advanced Placement Program	EDU	420,191		72,861
84.331	Grants to States for Incarcerated Youth Offenders	CORR	291,814		
84.332	Comprehensive School Reform Demonstration	EDU	4,314,591		4,181,372
84.334	Gaining Early Awareness and Readiness for Undergraduate Programs (Note 2)	CPE	1,941,234		1,243,799
84.336	Teacher Quality Enhancement Grants	EPSB	1,715,844		
84.343	Assistive Technology - State Grants for Protection and Advocacy	PUBAD	65,084		
84.346	Vocational Education-Occupational and Employment Information State Grants	DWI	187,696		2,364
84.350	Transition to Teaching	EDU	154,166		121,998
84.352	School Renovation Grants (Note 14)	EDU			
84.357	Reading First State Grants	EDU	14,186,198		13,171,531
84.358	Rural Education	EDU	7,417,599		7,417,599
84.365	English Language Acquisition Grants	EDU	2,022,788		1,963,106
84.366	Mathematics and Science Partnerships	EDU	1,652,831		1,639,222
84.367	Improving Teacher Quality State Grants (Note 2)	EDU	41,950,206		41,703,236
		CPE	1,231,317		1,224,202
84.369	Grants for State Assessments and Related Activities	EDU	10,250,673		200,329
84.372	Statewide Data Systems	EDU	62,307		
84.938	Hurricane Education Recovery	EDU	2,725,791		2,727,291
Passed Through From the Harlan Independent Board of Education:					
84.215	Fund for the Improvement of Education	KHS	430,931		
	Pass Through Grantor # - Various (Note 12)				
Passed Through From the Letcher County Board of Education:					
84.215	Fund for the Improvement of Education	KHS	215,174		
	Pass Through Grantor # - Various (Note 12)				
Passed Through From Bowling Green State University:					
84.304	Civic Education-Cooperative Education Exchange Program	AOC	12,500		
	Pass Through Grantor # - Various (Note 12)				
Passed Through From the Center for Civic Education:					
84.929	We the People	AOC	64,112		
	Pass Through Grantor # - Various (Note 12)				
Total U.S. Department of Education			\$ 696,462,098	\$	\$ 479,171,867

See accompanying Notes to the Schedule of Expenditures of Federal Awards



**COMMONWEALTH OF KENTUCKY**  
**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**  
**FEDERAL ASSISTANCE PROGRAMS**  
**FOR THE YEAR ENDED JUNE 30, 2006**  
**(CONTINUED)**

CFDA	Program Title	State Agency	Expenditures		Provided to Subrecipient
			Cash	Noncash	
<b><u>U.S. National Archives and Records Administration</u></b>					
<b>Direct Programs:</b>					
89.003	National Historical Publications and Records Grants (Note 14)	DLA KHS	\$ 4,814	\$	\$
<b>Total U.S. National Archives and Records Administration</b>			<u>\$ 4,814</u>	<u>\$</u>	<u>\$</u>
<b><u>U.S. Election Assistance Commission</u></b>					
<b>Direct Programs:</b>					
90.401	Help America Vote Act Requirements Payments	KBE	<u>\$ 18,552,253</u>	<u>\$</u>	<u>\$ 18,440,990</u>
<b>Total U.S. Election Assistance Commission</b>			<u>\$ 18,552,253</u>	<u>\$</u>	<u>\$ 18,440,990</u>
<b><u>U.S. Department of Health and Human Services</u></b>					
<b>Direct Programs:</b>					
93.003	Public Health and Social Services Emergency Fund	CHFS EMSB	\$ 727,009 550,096	\$	\$
93.041	Special Programs for the Aging - Title VII, Chapter 3 - Programs for Prevention of Elder Abuse, Neglect, and Exploitation	CHFS	70,518		70,518
93.042	Special Programs for the Aging - Title VII, Chapter 2 - Long Term Care Ombudsman Services for Older Individuals	CHFS	171,199		109,172
93.043	Special Programs for the Aging - Title III, Part D - Disease Prevention and Health Promotion Services	CHFS	305,212		303,212
<b>Aging Cluster:</b>					
93.044	Special Programs for the Aging - Title III, Part B - Grants for Supportive Services and Senior Centers	CHFS	5,231,192		4,865,748
93.045	Special Programs for the Aging - Title III, Part C - Nutrition Services	CHFS	7,897,126		7,412,534
93.053	Nutrition Services Incentive Program	CHFS	1,856,892		1,856,892
93.048	Special Programs for the Aging Title IV and Title II Discretionary Projects	CHFS	45,102		27,891
93.051	Alzheimer's Disease Demonstration Grants to States	CHFS	190,651		159,636
93.052	National Family Caregiver Support	CHFS	2,354,283		2,190,089
93.104	Comprehensive Community Mental Health Services for Children with Serious Emotional Disturbances (SED) (Note 9)	CHFS	1,187,108		1,179,490
93.110	Maternal and Child Health Federal Consolidated Programs	CHFS EDU	260,008 5,215		209,133
93.116	Project Grants and Cooperative Agreements for Tuberculosis Control Programs (Note 13)	CHFS	867,858	94,127	675,510
93.127	Emergency Medical Services for Children	EMSB	102,252		
93.130	Primary Care Services - Resource Coordination and Development	CHFS	65,344		24,000
93.136	Injury Prevention and Control Research and State and Community Based Programs	CHFS	1,073,650		1,073,650
93.138	Protection and Advocacy for Individuals with Mental Illness	PUBAD	409,913		
93.150	Projects for Assistance In Transition from Homelessness (PATH)	CHFS	393,000		393,000
93.197	Childhood Lead Poisoning Prevention Projects - State and Local Childhood Lead Poisoning Prevention and Surveillance of Blood Lead Levels in Children	CHFS	653,134		560,295
93.217	Family Planning - Services	CHFS	5,864,486		5,313,176
93.230	Consolidated Knowledge Development and Application (KD&A) Program	CHFS	19,792		19,792
93.234	Traumatic Brain Injury State Demonstration Grant Program	CHFS	207,758		207,758

See accompanying Notes to the Schedule of Expenditures of Federal Awards

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FEDERAL ASSISTANCE PROGRAMS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

CFDA	Program Title	State Agency	Expenditures		Provided to Subrecipient
			Cash	Noncash	
<b><u>U.S. Department of Health and Human Services (Continued)</u></b>					
<b>Direct Programs (Continued):</b>					
93.235	Abstinence Education Program	CHFS	752,837		711,051
93.238	Cooperative Agreements for State Treatment Outcomes and Performance Pilot Studies Enhancement	CHFS	78,139		49,723
93.242	Mental Health Research Grants (Note 9)	CHFS	58,139		57,404
93.243	Substance Abuse and Mental Health Services-Projects of Regional and National Significance (Note 14)	CHFS	1,177,442		1,096,792
		AOC	42,529		
		JUV	12,637		
		EDU	7,418		
		JUST			
93.251	Universal Newborn Hearing Screening	CHFS	122,488		
93.259	Rural Access to Emergency Devices Grant	EMSB	217,850		
93.262	Occupational Safety and Health Program	CHFS	100,000		100,000
93.267	State Grants for Protection and Advocacy Services	PUBAD	52,880		
93.268	Immunization Grants (Note 2) (Note 13)	CHFS	2,785,377	17,963,122	1,458,485
93.276	Drug-Free Communities Support Program Grants	KVE	21,028		
93.283	Centers for Disease Control and Prevention-Investigations and Technical Assistance (Note 13)	CHFS	18,928,989	184,885	11,096,017
		MIL	34,054		
93.556	Promoting Safe and Stable Families	CHFS	5,996,918		1,991,694
93.558	Temporary Assistance for Needy Families (Note 2) (Note 14)	CHFS	126,756,492		11,866,744
		DWI	3,192,862		
		OAG			
		KHCORP			
93.563	Child Support Enforcement (Note 2)	CHFS	41,002,716		26,986,417
		OAG	152,476		
93.568	Low-Income Home Energy Assistance (Note 2)	CHFS	27,735,311		27,536,488
93.569	Community Services Block Grant	CHFS	10,487,838		8,582,458
93.571	Community Services Block Grant Formula and Discretionary Awards	CHFS	52,156		52,156
	Community Food and Nutrition Programs				
<b>Child Care Cluster:</b>					
93.575	Child Care and Development Block Grant (Note 2)	CHFS	45,630,359		548,291
93.596	Child Care Mandatory and Matching Funds of the Child Care and Development Fund (Note 2)	CHFS	77,929,086		7,613,029
93.576	Refugee and Entrant Assistance - Discretionary Grants	EDU	130,352		130,352
93.585	Empowerment Zones Program	FAC	229,398		229,398
93.586	State Court Improvement Program	AOC	175,387		
93.590	Community-Based Child Abuse Prevention Grants	CHFS	1,921,463		492,373
		AOC	1,819		
93.597	Grants to States for Access and Visitation Programs	CHFS	101,180		101,166
93.599	Chafee Education and Training Vouchers Program (ETV)	CHFS	405,479		
93.600	Head Start	EDU	179,477		64,480
93.603	Adoption Incentive Payments (Note 14)	CHFS			
93.618	Voting Access for Individuals with Disabilities-Grants for Protection and Advocacy Systems	PUBAD	103,461		
93.630	Developmental Disabilities Basic Support and Advocacy Grants	CHFS	1,085,291		551,724
		PUBAD	706,984		
		DWI	40,000		
93.643	Children's Justice Grants to States (Note 9)	AOC	285,221		
		CHFS	19,358		
		OAG	44,162		
93.645	Child Welfare Services-State Grants	CHFS	4,500,357		
93.647	Social Services Research and Demonstration	CHFS	190,729		

See accompanying Notes to the Schedule of Expenditures of Federal Awards

**COMMONWEALTH OF KENTUCKY**  
**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**  
**FEDERAL ASSISTANCE PROGRAMS**  
**FOR THE YEAR ENDED JUNE 30, 2006**  
**(CONTINUED)**

CFDA	Program Title	State Agency	Expenditures		Provided to Subrecipient
			Cash	Noncash	
U.S. Department of Health and Human Services (Continued)					
Direct Programs (Continued):					
93.658	Foster Care-Title IV-E (Note 2)	CHFS	50,977,494		
		JUV	3,114,642		
		AOC	272,552		
93.659	Adoption Assistance (Note 2)	CHFS	23,534,476		
93.667	Social Services Block Grant (Note 2)	CHFS	23,093,090		778,354
		JUV	7,569,982		
93.669	Child Abuse and Neglect State Grants	CHFS	186,905		82,998
93.671	Family Violence Prevention and Services/Grants for Battered Women's Shelters/Grants to State and Indian Tribes	CHFS	1,318,971		1,303,518
93.674	Chafee Foster Care Independence Program	CHFS	1,626,790		1,049,367
93.767	State Children's Insurance Program (Note 2)	CHFS	77,241,521		117,605
Medicaid Cluster:					
93.775	State Medicaid Fraud Control Units (Note 2)	OAG	2,047,669		
93.777	State Survey and Certification of Health Care Providers and Suppliers (Note 2)	CHFS	7,001,007		
93.778	Medical Assistance Program (Note 2) (Note 14)	CHFS OAG	3,218,941,015		
93.779	Centers for Medicare and Medicaid Services (CMS) Research, Demonstration and Evaluations	CHFS	714,622		554,177
93.781	Seed Grants to States for Qualified High-Risk Pools	EPPC	266,985		
93.889	National Bioterrorism Hospital Preparedness Program	CHFS	7,243,682		7,196,645
		MIL	176,475		
93.917	HIV Care Formula Grants	CHFS	7,363,160		2,180,332
93.938	Cooperative Agreements to Support Comprehensive School Health Programs to Prevent the Spread of HIV and Other Important Health Problems	EDU CHFS	588,626 142,246		465,043 59,236
93.940	HIV Prevention Activities - Health Department Based (Note 13)	CHFS	1,825,859	11,900	1,493,781
93.944	Human Immunodeficiency Virus (HIV)/Acquired Immunodeficiency Virus Syndrome (AIDS) Surveillance	CHFS	113,456		31,437
93.945	Assistance Programs for Chronic Disease Prevention and Control	CHFS	305,319		186,941
93.952	Trauma Care Systems Planning and Development	EMSB	42,972		
93.958	Block Grants for Community Mental Health Services	CHFS	5,996,109		5,944,033
		DWI	75,000		
		CORR	50,000		
93.959	Block Grants for Prevention and Treatment of Substance Abuse (Note 2)	CHFS JUST KSP	20,717,585 100,000 39,946		20,680,650
93.977	Preventive Health Services - Sexually Transmitted Diseases Control Grants (Note 13)	CHFS	888,046	244,449	156,051
93.982	Mental Health Disaster Assistance and Emergency Mental Health	MIL	93,629		
93.988	Cooperative Agreements for State-Based Diabetes Control Programs and Evaluation of Surveillance Systems	CHFS	572,251		512,408
93.991	Preventive Health and Health Services Block Grant	CHFS	725,733		717,964
93.994	Maternal and Child Health Services Block Grant to the States	CHFS	10,238,272		5,410,893
Total U.S. Department of Health and Human Services			\$ 3,879,163,024	\$ 18,498,483	\$ 176,889,171
U.S. Corporation for National and Community Service					
Direct Programs:					
94.003	State Commissions	CHFS	\$ 186,570	\$	\$
94.004	Learn and Serve America-School and Community Based Programs	EDU	265,796		249,977
94.006	AmeriCorps	CHFS	1,951,111		1,951,079

See accompanying Notes to the Schedule of Expenditures of Federal Awards

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FEDERAL ASSISTANCE PROGRAMS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

CFDA	Program Title	State Agency	Expenditures		Provided to Subrecipient
			Cash	Noncash	
<b><u>U.S. Corporation for National and Community Service (Continued)</u></b>					
<b>Direct Programs (Continued):</b>					
94.007	Planning and Program Development Grants	CHFS	40,305		
94.009	Training and Technical Assistance	CHFS	120,741		
<b>Foster Grandparents/Senior Companion Cluster:</b>					
94.011	Foster Grandparent Program	CHFS	577,934		
94.NA(1)	Clinical Laboratory Improvement Act	CHFS	265,524		
<b>Total U.S. Corporation for National and Community Service</b>			<u>\$ 3,407,981</u>	<u>\$</u>	<u>\$ 2,201,056</u>
<b><u>U.S. Social Security Administration</u></b>					
<b>Direct Programs:</b>					
<b>Disability Insurance/SSI Cluster:</b>					
96.001	Social Security-Disability Insurance (Note 2)	CHFS	\$ 41,527,730	\$	\$
96.009	Social Security State Grants for Work Incentive Assistance to Disabled Beneficiaries	PUBAD	110,475		
<b>Total U.S. Social Security Administration</b>			<u>\$ 41,638,205</u>	<u>\$</u>	<u>\$</u>
<b><u>U. S. Department of Homeland Security</u></b>					
<b>Direct Programs:</b>					
<b>Homeland Security Cluster:</b>					
97.004	State Domestic Preparedness Equipment Support Program (Note 2) (Note 14)	KOHS	\$ 27,010,782	\$	\$ 26,081,170
		MIL	3,783,379		3,026,743
		KSP	2,973,609		
		DCJT	1,582,281		309,726
		COT	1,327,776		
		KVE	202,511		
		EPPC	131,434		
		AGR	35,435		
		TC			
		EMSB			
97.067	Homeland Security Grant Program (Note 2) (Note 14)	KOHS	8,058,590		7,473,061
		MIL	3,681,164		824,021
		DCJT	931,678		11,691
		PARKS	549,900		
		KSP	267,258		
		JUST	20,420		
		TC	19,669		
		AGR	300		
		EPPC			
97.008	Urban Areas Security Initiative	KOHS	3,219,252		3,219,252
97.012	Boating Safety Financial Assistance	F&W	1,151,731		
97.017	Pre-Disaster Mitigation (PDM) Competitive Grants	MIL	114,117		114,117
97.020	Hazardous Materials Training Program	MIL	1,068		
97.023	Community Assistance Program State Support Services Element (CAP-SSSE)	EPPC	122,241		
97.029	Flood Mitigation Assistance	TC	41,742		
97.032	Crisis Counseling	MIL	20,730		
97.034	Disaster Unemployment Assistance (Note 14)	DWI			

See accompanying Notes to the Schedule of Expenditures of Federal Awards

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FEDERAL ASSISTANCE PROGRAMS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

CFDA	Program Title	State Agency	Expenditures		Provided to Subrecipient
			Cash	Noncash	
<b><u>U.S. Department of Homeland Security (Continued)</u></b>					
<b>Direct Programs (Continued):</b>					
97.036	Disaster Grants-Public Assistance (Presidentially Declared Disasters) (Note 14)	MIL	13,721,106		13,587,682
		TC	1,223,484		
		KSP	10,639		
		PARKS			
97.039	Hazardous Mitigation Grant	MIL	2,157,173		2,132,352
97.040	Chemical Stockpile Emergency Preparedness Program	MIL	5,466,958		4,663,111
		CHFS	198,884		52,515
97.041	National Dam Safety Program	EPPC	63,421		293
97.042	Emergency Management Performance Grants (Note 14)	KOHS			
97.045	Cooperating Technical Partners	EPPC	375,133		
97.047	Pre-Disaster Mitigation	MIL	110,388		110,388
97.063	Pre-Disaster Mitigation Disaster Resistant Universities	MIL	18,558		18,588
97.070	Map Modernization Management Support	EPPC	106,703		
97.078	Buffer Zone Protection Plan (BZPP)	KOHS	1,356,635		1,356,627
		KSP	43,675		
97.089	Real ID Program	TC	1,101		
97.NA(1)	Hurricane Katrina Public Assistance Grant	KHCORP	384,585		
<b>Total U.S. Department of Homeland Security</b>			<u>\$ 80,485,510</u>	<u>\$</u>	<u>\$ 62,981,337</u>
<b><u>Other Federal Assistance</u></b>					
<b>Direct Programs:</b>					
NA	Joint Funding Administration (Note 8)	GOLD	<u>\$ 978,000</u>	<u>\$</u>	<u>\$ 978,000</u>
<b>Total Other Federal Assistance</b>			<u>\$ 978,000</u>	<u>\$</u>	<u>\$ 978,000</u>
<b>Total All State Agencies</b>			<u>\$ 6,423,944,065</u>	<u>\$ 938,133,797</u>	<u>\$ 1,135,148,576</u>

See accompanying Notes to the Schedule of Expenditures of Federal Awards

**COMMONWEALTH OF KENTUCKY**  
**NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**  
**FOR THE YEAR ENDED JUNE 30, 2006**

**Note 1 - Purpose of the Schedule and Significant Accounting Policies**

**Basis of Presentation** - OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, requires a Schedule of Expenditures of Federal Awards showing each federal financial assistance program as identified in the *Catalog of Federal Domestic Assistance*. The accompanying schedule includes all federal grant activity for the Commonwealth, except those programs administered by state universities, and is presented primarily on the basis of cash disbursements as modified by the application of Kentucky Revised Statute (KRS) 45.229. Consequently, certain expenditures are recorded in the accounts only when cash is disbursed. The Commonwealth elected to exclude state universities from the statewide single audit, except as part of the audit of the basic financial statements.

KRS 45.229 provides that the Finance and Administration Cabinet may, “for a period of thirty (30) days after the close of any fiscal year, draw warrants against the available balances of appropriations made for that fiscal year, for the payment of expenditures incurred during that year or in fulfillment of contracts properly made during the year, but for no other purpose.” However, there is an exception to the application of KRS 45.229 in that regular payroll expenses incurred during the last pay period of the fiscal year are charged to the next year.

The basic financial statements of the Commonwealth are presented on the modified accrual basis of accounting for the governmental fund financial statements and the accrual basis of accounting for the government-wide, proprietary fund, and fiduciary fund financial statements. Therefore, the schedule may not be directly traceable to the basic financial statements in all cases.

Noncash assistance programs are not reported in the basic financial statements of the Commonwealth for FY 06. The noncash expenditures presented on this schedule represent the noncash assistance expended using the method or basis of valuation described in Note 13.

Clusters of programs are indicated in the schedule by light gray shading.

Programs that do not have CFDA numbers are identified using the two-digit federal identifier prefix, and the letters “NA” to denote that no specific number is applicable. Each program is numbered in parentheses, following the NA for each federal grantor.

The state agencies’ schedule is presented on the cash, modified cash, or accrual basis of accounting.

**COMMONWEALTH OF KENTUCKY**  
**NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**  
**FOR THE YEAR ENDED JUNE 30, 2006**  
**(CONTINUED)**

**Note 1 - Purpose of the Schedule and Significant Accounting Policies (Continued)**

**Inter-Agency Activity** - Certain transactions relating to federal financial assistance may appear in the records of more than one (1) state agency. To avoid the overstatement of federal expenditures, the following policies were adopted for the presentation of the schedule:

- (a) Federal moneys may be received by a state agency and passed through to another state agency where the moneys are expended. Except for pass-throughs to state universities as discussed below, this inter-agency transfer activity is reported by the agency expending the moneys.

State agencies that pass federal funds to state universities report those amounts as expenditures.

- (b) Federal moneys received by a state agency and used to purchase goods or services from another state agency are reported in the schedule as an expenditure by the purchasing agency only.

**Note 2 - Type A Programs**

Type A programs for the Commonwealth mean any program for which total expenditures of federal awards exceeded \$20 million for FY 06. The Commonwealth had the following programs (cash and noncash) that met the Type A program definition for FY 06, some of which were administered by more than one (1) state agency. Certain component units and agencies audited by certified public accounting firms had lower dollar thresholds. The Commonwealth identified clusters among the Type A programs by gray shading. These Type A programs and clusters were:

<b><u>CFDA</u></b>	<b><u>Program Title</u></b>	<b><u>Expenditures</u></b>
<b>Food Stamp Cluster:</b>		
<b>10.551</b>	Food Stamps	\$ 640,370,080
<b>10.561</b>	State Administrative Matching Grants for Food Stamp Program	31,541,989
<b>Child Nutrition Cluster:</b>		
<b>10.553</b>	School Breakfast Program	41,729,192
<b>10.555</b>	National School Lunch Program	121,606,547
<b>10.556</b>	Special Milk Program for Children	73,945
<b>10.559</b>	Summer Food Service Program for Children	8,102,061
<b>10.557</b>	Special Supplemental Nutrition Program for Women, Infants, and Children	105,067,616

**COMMONWEALTH OF KENTUCKY**  
**NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**  
**FOR THE YEAR ENDED JUNE 30, 2006**  
**(CONTINUED)**

**Note 2 - Type A Programs (Continued)**

<b><u>CFDA</u></b>	<b><u>Program Title</u></b>	<b><u>Expenditures</u></b>
<b>10.558</b>	Child and Adult Care Food Program	25,966,265
<b>10.766</b>	Community Facilities Loans and Grants	66,327,317
<b>14.117</b>	Mortgage Insurance - Homes	169,038,027
<b>Section 8 Project-Based Cluster:</b>		
<b>14.182</b>	Lower Income Housing Assistance Program - Section 8 New Construction/Substantial Rehabilitation	89,902,822
<b>14.856</b>	Lower Income Housing Assistance Program - Section 8 Moderate Rehabilitation	72,722
<b>14.228</b>	Community Development Block Grants/State's Program	35,621,964
<b>14.871</b>	Section 8 Housing Choice Vouchers	20,558,951
<b>17.225</b>	Unemployment Insurance	389,814,259
<b>17.245</b>	Trade Adjustment Assistance	27,288,117
<b>Workforce Investment Act Cluster:</b>		
<b>17.258</b>	WIA Adult Program	15,883,222
<b>17.259</b>	WIA Youth Activities	13,481,311
<b>17.260</b>	WIA Dislocated Workers	20,312,160
<b>Highway Planning and Construction Cluster:</b>		
<b>20.205</b>	Highway Planning and Construction	521,840,100
<b>64.114</b>	Veterans Housing-Guaranteed and Insured Loans	17,168,120
<b>66.458</b>	Capitalization Grants for Clean Water State Revolving Funds	18,972,541
<b>66.468</b>	Capitalization Grants for Drinking Water State Revolving Funds	7,501,781
<b>84.002</b>	Adult Education-State Grant Program	9,241,323
<b>84.010</b>	Title I Grants to Local Educational Agencies	185,351,725
<b>Special Education Cluster:</b>		
<b>84.027</b>	Special Education - Grants to States	149,250,349
<b>84.173</b>	Special Education - Preschool Grants	9,860,785



**COMMONWEALTH OF KENTUCKY**  
**NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**  
**FOR THE YEAR ENDED JUNE 30, 2006**  
**(CONTINUED)**

**Note 2 - Type A Programs (Continued)**

<b><u>CFDA</u></b>	<b><u>Program Title</u></b>	<b><u>Expenditures</u></b>
<b>Student Financial Assistance Program Cluster:</b>		
<b>84.032</b>	Federal Family Education Loans	137,651,196
<b>84.126</b>	Rehabilitation Services - Vocational Rehabilitation Grants to States	45,482,786
<b>84.334</b>	Gaining Early Awareness and Readiness for Undergraduate Programs	1,941,234
<b>84.367</b>	Improving Teacher Quality State Grants	43,181,523
<b>93.268</b>	Immunization Grants	20,748,499
<b>93.558</b>	Temporary Assistance for Needy Families	129,949,354
<b>93.563</b>	Child Support Enforcement	41,155,192
<b>93.568</b>	Low-Income Home Energy Assistance	27,735,311
<b>Child Care Cluster:</b>		
<b>93.575</b>	Child Care and Development Block Grant	45,630,359
<b>93.596</b>	Child Care Mandatory and Matching Funds of the Child Care and Development Fund	77,929,086
<b>93.658</b>	Foster Care-Title IV-E	54,364,688
<b>93.659</b>	Adoption Assistance	23,534,476
<b>93.667</b>	Social Services Block Grant	30,663,072
<b>93.767</b>	State Children's Insurance Program	77,241,521
<b>Medicaid Cluster:</b>		
<b>93.775</b>	State Medicaid Fraud Control Units	2,047,669
<b>93.777</b>	State Survey and Certification of Health Care Providers and Suppliers	7,001,007
<b>93.778</b>	Medical Assistance Program	3,218,941,015
<b>93.959</b>	Block Grants for Prevention and Treatment of Substance Abuse	20,857,531
<b>Disability Insurance/SSI Cluster:</b>		
<b>96.001</b>	Social Security - Disability Insurance	41,527,730

**COMMONWEALTH OF KENTUCKY**  
**NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**  
**FOR THE YEAR ENDED JUNE 30, 2006**  
**(CONTINUED)**

**Note 2 - Type A Programs (Continued)**

<b><u>CFDA</u></b>	<b><u>Program Title</u></b>	<b><u>Expenditures</u></b>
<b>Homeland Security Cluster:</b>		
<b>97.004</b>	State Domestic Preparedness Equipment Support Program	37,047,207
<b>97.067</b>	Department for Homeland Security Grant Program	13,528,979
<b>Total Type A Programs</b>		<b>\$ 6,840,104,956</b>

**Note 3 - Federally Assisted Loan Programs**

The Commonwealth has several loan programs made possible with initial advances in prior years from the federal government. In addition, the federal government guarantees some loan programs.

a) The Kentucky Rural Rehabilitation Student Loan Program was initially awarded \$672,629 in 1970 by the U. S. Farmers Home Administration. Since 1970, the program has operated on interest from student loans outstanding and on income from investments administered by the Office of Financial Management. The Department of Agriculture is no longer in the business of making student loans and reassigned all loans in payment compliance to the Kentucky Higher Education Assistance Authority (KHEAA). The Department of Agriculture retained only those loans that had a delinquent payment history. This program is currently in phase-out status, with authorization from the U. S. Department of Agriculture (USDA) to eliminate the principal through issuance of specific grants and scholarships. Most outstanding loans have been classified as contingent uncollectible liabilities; however, if loan payments are received, they are directly deposited into the principal account. The total amount of money in the investment account as of June 30, 2006 was \$516,297. Student loans and investment earned interest of \$15,761. Outstanding student loans totaled \$64,466. The total grants and scholarships authorized by the USDA in FY 06 totaled \$111,754.

b) The Kentucky Higher Education Student Loan Corporation (KHESLC) issues revenue bonds in order to purchase student loans authorized under the Federal Family Education Loans program (CFDA 84.032). The KHEAA guarantees substantially all loans made and purchased by the KHESLC. The U.S. Department of Education provides for reinsurance of loans guaranteed by the KHEAA.

**COMMONWEALTH OF KENTUCKY**  
**NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**  
**FOR THE YEAR ENDED JUNE 30, 2006**  
**(CONTINUED)**

**Note 3 - Federally Assisted Loan Programs (Continued)**

c) The Kentucky Infrastructure Authority administers wastewater and drinking water revolving loan programs (CFDA 66.458 and 66.468) funded by the U.S. Environmental Protection Agency's Capitalization Grants for State Revolving Funds. During the year ended June 30, 2006, the Authority issued loans totaling \$24,638,859 (federal portion), with outstanding loans of \$331,004,403 at year-end.

d) The Department of Housing and Urban Development's Mortgage Insurance-Homes (CFDA 14.117), Department of Agriculture's Community Facilities Loans and Grants (CFDA 10.766), and Department of Veterans Affairs' Veterans Housing-Guaranteed and Insured Loans (CFDA 64.114) represent the loans originated in FY 04 by the Kentucky Housing Corporation. The cumulative outstanding balance of the Mortgage Insurance Program, Community Facilities Loans and Grants Program, and Veterans Housing and Guaranteed Loans Program loans originated by the Kentucky Housing Corporation is \$874,076,411, \$344,693,073, and \$92,268,742, respectively as of June 30, 2006.

**Note 4 - Related to CFDA 81.039, 81.041, 81.117, and 81.119**

The Office of Energy Policy (formerly the Department of Energy) was moved from the Environmental and Public Protection Cabinet to the Commerce Cabinet in April 2005.

**Note 5 - Unemployment Insurance (CFDA 17.225)**

The Commonwealth paid out \$361,879,216 in benefits in FY 06. The amounts shown on the accompanying schedule reflect both the amount expended for benefits from the Trust Fund and an additional \$27,935,043 of federal funds expended for administration of the program, resulting in a combined total of \$389,814,259 in federal expenditures.

**Note 6 - Highway Planning and Construction (CFDA 20.205)**

The information reported for this 20.205 Highway Planning and Construction program represents the activity of all open projects during FY 06. These projects were funded from several apportionments. Apportionments refer to a federal, statutorily prescribed division or assignment of funds. The expenditures reflected on the schedule include expenditures for advance construction projects, which are not yet under agreements with the Federal Highway Administration.

Program Income - The Highway Planning and Construction Program earned program income of \$970,723 in FY 06. This income was earned in the right-of-way phase through the sale and rental of real property. Income earned in this manner was classified as a negative expenditure, resulting in a reduction to federal expenditures for the current year.

**COMMONWEALTH OF KENTUCKY  
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**Note 6 - Highway Planning and Construction (CFDA 20.205) (Continued)**

The Highway Planning and Construction Program also is comprised of \$5,893,905 for earned program income in relation to the Garvee Bonds.

Refunds - Expenditures for the Highway Planning and Construction Program were shown net of any refunds, resulting from a reimbursement of prior or current year expenditures. Refunds totaled \$2,410,804 for FY 06.

**Note 7 - Outdoor Recreation - Acquisition, Development and Planning (CFDA 15.916) and Recreational Trails Program (CFDA 20.219)**

Administrative costs are shown as expended when received from the federal government. These costs are recovered through a negotiated, fixed indirect cost rate. Any over or under recovery will be recouped in the future.

**Note 8 - Joint Funding Administration**

The Joint Funding Administration Program (listed in the schedule under Other Federal Assistance) consists of grants from the following federal agencies:

- U.S. Department of Commerce
- U.S. Department of Housing and Urban Development
- U.S. Appalachian Regional Commission

**Note 9 - Research and Development Expenditures**

OMB Circular A-133 Section 105 states, "Research and development (R&D) means all research activities, both basic and applied, and all development activities that are performed by a non-federal entity."

The expenditures presented in the SEFA include R&D expenditures. The R&D portion of the expenditures for each program is listed below.

**COMMONWEALTH OF KENTUCKY**  
**NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**  
**FOR THE YEAR ENDED JUNE 30, 2006**  
**(CONTINUED)**

**Note 9 - Research and Development Expenditures (Continued)**

<b>CFDA</b>	<b>Program Title</b>	<b>State Agency</b>	<b>Expenditures</b>
10.028	Wildlife Services	DFWR	\$ 248
15.605	Sport Fish Restoration	DFWR	1,113,603
15.615	Cooperative Endangered Species Conservation Fund	DFWR	84,680
15.634	State Wildlife Grants	DFWR	58,950
16.585	Drug Court Discretionary Grant Program	AOC	88,481
84.126	Rehabilitation Services-Vocational Rehabilitation Grants to States	DWI	67,939
93.104	Comprehensive Community Mental Health Services for Children with Serious Emotional Disturbances	CHFS	14,686
93.242	Mental Health Research Grants	CHFS	15,000
93.643	Children's Justice Grants to States	AOC	28,871
<b>Total Research &amp; Development Expenditures</b>			<u><u>\$ 1,472,458</u></u>

**Note 10 - Community Development Block Grants/State's Program (CFDA 14.228)**

The Commonwealth matches the federal portion of administration dollar for dollar. Cash expenditures include the federal portion of administration.

**Note 11 - Wildlife Restoration (CFDA 15.611)**

The Department of Fish and Wildlife Resources leases properties from the U.S. Army Corp of Engineers for Condition Three and Condition Five Projects. These projects stipulate that the properties leased be managed for wildlife purposes and may produce income. The leases for wildlife management rights on these properties are non-monetary. The Department of Fish and Wildlife Resources currently leases the following properties:

- Barren River
- Green River
- Dewey Lake
- Fishtrap Lake

Any expenditure in excess of revenue from each property listed above will be eligible for reimbursement under the Wildlife Restoration grant (CFDA 15.611) from the U.S. Department of the Interior. The properties listed above are not reimbursed with federal funds if the grant has already been expended to manage other wildlife properties.

**COMMONWEALTH OF KENTUCKY**  
**NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**  
**FOR THE YEAR ENDED JUNE 30, 2006**  
**(CONTINUED)**

**Note 12 - Pass Through Programs**

OMB Circular A-133 Section 105 defines a recipient as “a non-Federal entity that expends Federal awards received directly from a Federal awarding agency to carry out a Federal program” and a pass-through entity as “a non-Federal entity that provides a Federal award to a subrecipient to carry out a Federal program.”

Federal program funds can be received directly from the federal government or passed through from another entity. Below is a list of all federal programs that are either (1) passed through, or (2) both direct and passed through.

<b>Received From</b>	<b>Direct/Pass Through (Grantor #)</b>	<b>State Agency</b>	<b>Amount</b>
<b><u>Public Safety Partnership and Community Policing Grants (CFDA #16.710)</u></b>			
U.S. Department of Justice			
	Direct	KSP	\$ 242,730
	Direct	OAG	122,753
<b>Total Public Safety Partnership and Community Policing Grants</b>			<b>\$ 365,483</b>
<b><u>Fund for the Improvement of Education (CFDA 84.215)</u></b>			
U.S. Department of Education			
	Direct	KHS	\$ 49,296
	Direct	EDU	2,342
Harlan Independent Board of Education			
	Pass Through (Various)	KHS	430,931
Letcher County Board of Education			
	Pass Through (Various)	KHS	215,174
<b>Total Fund for the Improvement of Education</b>			<b>\$ 697,743</b>
<b><u>Civic Education - Cooperative Education Exchange Program (CFDA 84.304)</u></b>			
Bowling Green State University	Pass Through (Q304B040001)	AOC	\$ 11,250
Bowling Green State University	Pass Through (Q304A030004)	AOC	1,250
<b>Total Civic Education - Cooperative Education Exchange Program</b>			<b>\$ 12,500</b>

**COMMONWEALTH OF KENTUCKY**  
**NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**  
**FOR THE YEAR ENDED JUNE 30, 2006**  
**(CONTINUED)**

**Note 12 - Pass Through Programs (Continued)**

<b>Received From</b>	<b>Direct/Pass Through (Grantor #)</b>	<b>State Agency</b>	<b>Amount</b>
<b><u>We the People (CFDA 84.929)</u></b>			
Center for Civic Education	Pass Through (Various)	AOC	\$ 64,112
<b>Total We The People</b>			<u>\$ 64,112</u>

**Note 13 - Noncash Expenditure Programs**

The Commonwealth's noncash programs and a description of the method/basis of valuation follow.

<b>CFDA</b>	<b>Program Title</b>	<b>Amount</b>	<b>Method/Basis of Valuation</b>
10.551	Food Stamps	\$ 640,370,080	Electronic Benefit Transfer Issuance
10.550	Food Donation	16,118,608	Commodities issued per ECOS report dated 8/23/06.
10.565	Commodity Supplemental Food Program	5,016,772	Quantity issued to recipients valued using April 2006 Commodity File.
10.569	Emergency Food Assistance Program (Food Commodities)	4,457,261	Quantity issued to recipients valued using April 2006 Commodity File.
10.664	Cooperative Forestry Assistance	155,427	Acquisition Cost as indicated by Government Services Administration (GSA).
10.766	Community Facilities Loans and Grants	66,327,317	Book value of loans.
10.914	Wildlife Habitat Incentive Program	17,499	Per award, \$70,000 per year, \$5,833 per month.
14.117	Mortgage Insurance-Homes	169,038,027	Book value of loans.
15.250	Regulation of Surface Coal Mining and Surface Effects of Underground Coal Mining	33,589	Inventory of Controlled Property.

**COMMONWEALTH OF KENTUCKY**  
**NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**  
**FOR THE YEAR ENDED JUNE 30, 2006**  
**(CONTINUED)**

**Note 13 - Noncash Expenditure Programs (Continued)**

<b>CFDA</b>	<b>Program Title</b>	<b>Amount</b>	<b>Method/Basis of Valuation</b>
39.003	Donation of Federal Surplus Personal Property	675,066	23.3% of federal acquisition cost (\$2,897,278).
64.114	Veterans Housing - Guaranteed and Insured Loans	17,168,120	Book value of loans.
66.034	National Air Toxic Trend Site (Section 103)	17,088	EPA Contract with Eastern Research Group
66.419	Water Pollution Control Program	19,960	An estimated hourly rate for months: Nov, Dec, and Feb.
66.606	Surveys, Studies, Investigations and Special Purpose Grants	220,500	EPA contracts with Research Triangle and National Park Service and EPA contracts for performance audits and data analysis as well as actual cost of filters purchased by EPA for EPPC.
93.116	Project Grants and Cooperative Agreements for Tuberculosis Control Programs	94,127	Per authorized award for personnel.
93.268	Immunization Grants	17,963,122	Per authorized award for personnel, vaccine costs, travel, and other costs and National Immunization Program, CDC Orders Approved Report.
93.283	Centers for Disease Control and Prevention-Investigations and Technical Assistance	184,885	Per authorized award for personnel, travel, and other costs.
93.940	HIV Prevention Activities - Health Department Based	11,900	Per authorized award for personnel costs.
93.977	Preventive Health Services - Sexually Transmitted Diseases Control Grants	244,449	Per authorized award for personnel costs.
<b>Total Noncash Expenditures</b>		<u><u>\$ 938,133,797</u></u>	



**COMMONWEALTH OF KENTUCKY**  
**NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**  
**FOR THE YEAR ENDED JUNE 30, 2006**  
**(CONTINUED)**

**Note 14 - Zero Expenditure Programs**

These programs had no expenditures related to the respective state organization during FY 06. The zero expenditure programs included programs with no activity during the year, such as old programs not officially closed out or new programs issued late in the fiscal year. They also included programs with activity other than expenditures. For CFDA numbers with multiple state organizations listed, the schedule is presented in descending expenditure amount order.

**Note 15 - Federal Family Education Loans (CFDA 84.032)**

In the last three years, two of 256 data transmissions from the National Student Loan Clearinghouse (NSC) were determined to be interrupted. This resulted in several loans serviced by KHESLC not being placed in a repayment status on a timely basis. The unallowable interest and special allowance benefits related to the affected loans was approximately \$43,000. Of this amount, approximately \$35,000 related to loans owned by the Corporation and \$8,000 related to loans serviced on behalf of customers. Corrections were made to KHESLC's Student Loan Servicing System (SLSS) in August 2006 which will appropriately adjust interest and special allowance benefits in KHESLC's September 30, 2006 quarterly ED Form LaRS filing.

**Note 16 - Activity Occurring in Programs with Inventoriable Items**

The Department of Agriculture operates a warehouse in Louisville, Kentucky for the Commodity Supplemental Food Program (CFDA 10.565). The dollar value of the inventory is as follows:

	<b>Commodity Supplemental Food Program CFDA 10.565</b>
Beginning Inventory, July 1, 2005	\$ 546,284
Received	5,058,824
Issued to Recipients	(5,016,772)
Ending Inventory, June 30, 2006	<u>\$ 588,336</u>

**Note 17 - Byrd Honors Scholarships Program (CFDA 84.185)**

The Byrd Honors Scholarships Program was moved from the Kentucky Department of Education to the Kentucky Higher Education Assistance Authority.

**Note 18 - Election Reform Payments (CFDA 39.011)**

Interest earned must be used for additional program expenditures.

## **REPORTS ON COMPLIANCE AND ON INTERNAL CONTROL**



CRIT LUALLEN  
AUDITOR OF PUBLIC ACCOUNTS

Report On Internal Control Over Financial Reporting  
And On Compliance And Other Matters Based On An Audit Of  
Financial Statements Performed In Accordance With  
*Government Auditing Standards*

Honorable Ernie Fletcher, Governor  
Cabinet Secretaries and Agency Heads  
Members of the Commonwealth of Kentucky Legislature

We have audited the financial statements of the governmental activities, business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the Commonwealth of Kentucky as of and for the year ended June 30, 2006, which collectively comprise the Commonwealth's basic financial statements and have issued our report thereon dated December 19, 2006. Our report was modified to include a reference to other auditors. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Several agencies were tested for compliance and internal control requirements in accordance with *Government Auditing Standards* by other auditors, whose reports thereon have been furnished to us. This report does not include the results of the other auditors' testing of the universities' internal control over financial reporting or compliance and other matters that are reported separately by those auditors. However, the audit report for Kentucky State University has not been released as of the date of this report and therefore those financial statements have not been audited.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Commonwealth's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Commonwealth's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements.



Report On Internal Control Over Financial Reporting  
And On Compliance And Other Matters Based On An Audit Of  
Financial Statements Performed In Accordance With  
*Government Auditing Standards*  
(Continued)

Internal Control Over Financial Reporting (Continued)

Reportable conditions are described in the accompanying schedule of findings and questioned costs as items 06-CHFS1-1, 06-CHFS2-2, 06-CHFS3-3, 06-CHFS4-4, 06-CHFS5-5, 06-CHFS6-6, 06-DEI1-7, 06-DOC1-8, 06-DOC2-9, 06-DOC3-10, 06-DWI1-11, 06-DWI2-12, 06-DWI3-13, 06-DWI4-14, 06-EDU1-15, 06-EDU2-16, 06-EDU3-17, 06-EDU4-18, 06-EDU5-19, 06-EDU6-20, 06-FAC1-21, 06-FAC2-22, 06-FAC3-23, 06-FAC4-24, 06-FAC5-25, 06-FAC6-26, 06-FAC7-27, 06-FAC8-28, 06-KRYS1-29, 06-KST1-30, 06-KST2-31, 06-KST3-32, 06-KST4-33, 06-PERS1-34, 06-PERS2-35, 06-REV1-36, 06-REV2-37, 06-REV3-38, 06-REV4-39, 06-REV5-40, 06-TC1-41, 06-TC2-42, 06-TC3-43, and 06-TC4-44.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider none of them to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Commonwealth's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings and questioned costs as item 06-CHFS2-2, 06-CHFS6-6, and 06-FAC1-21.

We also noted other matters involving internal control over financial reporting, which we have reported to management in a separate letter.

Report On Internal Control Over Financial Reporting  
And On Compliance And Other Matters Based On An Audit Of  
Financial Statements Performed In Accordance With  
*Government Auditing Standards*  
(Continued)

This report is intended solely for the information and use of the management, and members of the legislature, and is not intended to be and should not be used by anyone other than these specified parties.

Sincerely,

A handwritten signature in black ink, appearing to read "Crit Luallen", with a long horizontal flourish extending to the right.

Crit Luallen  
Auditor of Public Accounts

December 19, 2006



CRIT LUALLEN  
AUDITOR OF PUBLIC ACCOUNTS

Report On Compliance With Requirements Applicable To Each  
Major Program And On Internal Control Over Compliance In  
Accordance With OMB Circular A-133 And On The  
Schedule Of Expenditures Of Federal Awards

Honorable Ernie Fletcher, Governor  
Cabinet Secretaries and Agency Heads  
Members of the Commonwealth of Kentucky Legislature

Compliance

We have audited the compliance of the Commonwealth of Kentucky with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2006. Several agencies were audited for compliance requirements in accordance with OMB Circular A-133 by other auditors, whose reports thereon have been furnished to us, and our opinion presented herein, insofar as it relates to these agencies listed in Appendix 1 to this report, is based on the reports of the other auditors.

The Commonwealth's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the Commonwealth's management. Our responsibility is to express an opinion on the Commonwealth's compliance based on our audit.

The Commonwealth's basic financial statements included the operations of the state universities, which expended \$970,428,344 in federal awards that are not included in the schedule of expenditures of federal awards for the year ended June 30, 2006. The expenditure amount for Kentucky State University was not available and no expenditures relating to Kentucky State University have been included in the above amount. Our audit, described below, did not include the operations of the state universities because they engaged other auditors to perform an audit in accordance with OMB Circular A-133.



Report On Compliance With Requirements Applicable To Each  
Major Program And On Internal Control Over Compliance In  
Accordance With OMB Circular A-133 And On The  
Schedule Of Expenditures Of Federal Awards  
(Continued)

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Commonwealth's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the Commonwealth's compliance with those requirements.

In our opinion, based on our audit and the reports of other auditors, the Commonwealth complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2006. However, the results of our auditing procedures disclosed other instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as items 06-CHFS21-47, 06-CHFS22-48, 06-CHFS23-49, 06-CHFS24-50, 06-DFWR1-52, 06-DMA1-59, 06-DMA2-60, 06-JUST1-63, 06-JUST2-64, and 06-TC13-69.

We also noted certain immaterial instances of noncompliance, which we have reported to management in a separate letter.

Internal Control Over Compliance

The management of the Commonwealth is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the Commonwealth's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on the internal control over compliance in accordance with OMB Circular A-133.

Report On Compliance With Requirements Applicable To Each  
Major Program And On Internal Control Over Compliance In  
Accordance With OMB Circular A-133 And On The  
Schedule Of Expenditures Of Federal Awards  
(Continued)

We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect the Commonwealth's ability to administer a major federal program in accordance with the applicable requirements of laws, regulations, contracts, and grants. Reportable conditions are described in the accompanying schedule of findings and questioned costs as items 06-CHFS2-45, 06-CHFS20-46, 06-CHFS21-47, 06-CHFS22-48, 06-CHFS23-49, 06-CHFS24-50, 06-COMM1-51, 06-DFWR1-52, 06-DFWR2-53, 06-DFWR3-54, 06-DFWR4-55, 06-DFWR5-56, 06-DFWR6-57, 06-DFWR7-58, 06-DMA1-59, 06-DMA2-60, 06-DWI8-61, 06-DWI9-62, 06-JUST1-63, 06-JUST2-64, 06-KHEAA1-65, 06-KHEAA2-66, 06-KHESLC1-67, 06-TC12-68, and 06-TC13-69.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with the applicable requirements of laws, regulations, contracts, and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider none of them to be material weaknesses.

We also noted other matters involving internal control over compliance, which we have communicated to management in a separate letter.

Schedule of Expenditures of Federal Awards

We have audited the financial statements of the governmental activities, business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the Commonwealth as of and for the year ended June 30, 2006, and have issued our report thereon dated December 19, 2006. Our audit was performed for the purpose of forming opinions on the financial statements that collectively comprise the Commonwealth's basic financial statements. The



Report On Compliance With Requirements Applicable To Each  
Major Program And On Internal Control Over Compliance In  
Accordance With OMB Circular A-133 And On The  
Schedule Of Expenditures Of Federal Awards  
(Continued)

accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements taken as a whole.

Several schedules of expenditures of federal awards were audited by other auditors, whose reports thereon have been furnished to us, and our opinion presented herein, insofar as it relates to these agencies listed in Appendix 1 to this report, is based on the reports of the other auditors.

The basic financial statements of the Commonwealth are prepared on an accrual/modified accrual basis of accounting. However, the schedule of expenditures of federal awards of the Commonwealth is prepared on the basis of cash disbursements as modified by the application of KRS 45.229. Consequently, certain expenditures are recorded in the accounts only when cash is disbursed. Accordingly, the schedule of expenditures of federal awards is not intended to present the expenditures of federal awards in conformity with accounting principles generally accepted in the United States of America.

In our opinion, based on our audit and the reports of other auditors, except for the effect of the application of a different basis of accounting, as explained above, the schedule of expenditures of federal awards is fairly stated, in all material respects, in relation to the Commonwealth's basic financial statements taken as a whole.

This report is intended solely for the information and use of the management, members of the legislature, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Sincerely,



Crit Luallen  
Auditor of Public Accounts

Schedule of Expenditures of Federal Awards  
December 19, 2006

Federal Compliance  
March 2, 2007

## **SCHEDULE OF FINDINGS AND QUESTIONED COSTS**

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006**

**SECTION 1 - SUMMARY OF AUDITOR'S RESULTS**

**Financial Statements**

Financial Statements: We issued an unqualified opinion on the basic financial statements of the Commonwealth for the year ended June 30, 2006.

Compliance: In relation to the audit of the basic financial statements of the Commonwealth, and the Schedule of Expenditures of Federal Awards, the results of our tests disclosed three (3) instances of noncompliance that are required to be reported under *Government Auditing Standards*. We believe the instances of noncompliance are not material.

<u>STATE AGENCY</u>	<u>REPORTABLE</u>	<u>MATERIAL</u>
Cabinet for Health and Family Services (06-CHFS2-2, 06-CHFS6-6)	2	
Finance and Administration Cabinet (06-FAC1-21)	1	

Internal Control Over Financial Reporting: Our consideration of the Commonwealth's internal control over financial reporting disclosed 44 reportable conditions. We believe that none of the reportable conditions are material weaknesses. The reportable conditions, which were disclosed during our audit, are applicable to the following state agencies:

<u>STATE AGENCY</u>	<u>REPORTABLE</u>	<u>MATERIAL</u>
Cabinet for Health and Family Services (06-CHFS1-1, 06-CHFS2-2, 06-CHFS3-3, 06-CHFS4-4, 06-CHFS5-5, 06-CHFS6-6)	6	
Department of Employee Insurance (06-DEI1-7)	1	
Department of Corrections (06-DOC1-8, 06-DOC2-9, 06-DOC3-10)	3	
Department for Workforce Investment (06-DWI1-11, 06-DWI2-12, 06-DWI3-13, 06-DWI4-14)	4	
Department of Education (06-EDU1-15, 06-EDU2-16, 06-EDU3-17, 06-EDU4-18, 06-EDU5-19, 06-EDU6-20)	6	

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 1 - SUMMARY OF AUDITOR'S RESULTS (CONTINUED)**

**Financial Statements (Continued)**

<u>STATE AGENCY</u>	<u>REPORTABLE</u>	<u>MATERIAL</u>
Finance and Administration Cabinet (06-FAC1-21, 06-FAC2-22, 06-FAC3-23, 06-FAC4-24, 06-FAC5-25, 06-FAC6-26, 06-FAC7-27, 05-FAC8-28)	8	
Kentucky Retirement System (06-KRYS1-29)	1	
Kentucky State Treasury (06-KST1-30, 06-KST2-31, 06-KST3-32, 06-KST4-33)	4	
Personnel Cabinet (06-PERS1-34, 06-PERS2-35)	2	
Department of Revenue (06-REV1-36, 06-REV2-37, 06-REV3-38, 06-REV4-39, 06-REV5-40)	5	
Transportation Cabinet (06-TC1-41, 06-TC2-42, 06-TC3-43, 06-TC4-44)	4	

**Federal Awards and Schedule of Expenditures of Federal Awards**

Compliance: We issued an unqualified opinion on the Commonwealth's compliance with the requirements applicable to each of its major federal programs. The results of our auditing procedures disclosed 10 instances of noncompliance, which are required to be reported in accordance with OMB Circular A-133. We believe none of the instances of noncompliance are material.

<u>STATE AGENCY</u>	<u>REPORTABLE</u>	<u>MATERIAL</u>
Cabinet for Health and Family Services (06-CHFS21-47, 06-CHFS22-48, 06-CHFS23-49, 06-CHFS24-50)	4	
Department of Fish & Wildlife Resources (06-DFWR1-52)	1	
Department of Military Affairs (06-DMA1-59, 06-DMA2-60)	2	

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 1 - SUMMARY OF AUDITOR'S RESULTS (CONTINUED)**

**Federal Awards and Schedule of Expenditures of Federal Awards (Continued)**

<u>STATE AGENCY</u>	<u>REPORTABLE</u>	<u>MATERIAL</u>
Justice Cabinet (06-JUST1-63, 06-JUST2-65)	2	
Transportation Cabinet (06-TC13-69)	1	

Internal Control Over Compliance: Our consideration of the Commonwealth's internal control over compliance disclosed 25 reportable conditions. We believe that none of the reportable conditions are material weaknesses. The reportable conditions, which were disclosed during our audit, are applicable to the following state agencies:

<u>STATE AGENCY</u>	<u>REPORTABLE</u>	<u>MATERIAL</u>
Cabinet for Health and Family Services (06-CHFS2-45, 06-CHFS20-46, 06-CHFS21-47, 06-CHFS22-48, 06-CHFS23-49, 06-CHFS24-50)	6	
Commerce Cabinet (06-COMM1-51)	1	
Department of Fish & Wildlife Resources (06-DFWR1-52, 06-DFWR2-53, 06-DFWR3-54, 06-DFWR4-55, 06-DFWR5-56, 06-DFWR6-57, 06-DFWR7-58)	7	
Department of Military Affairs (06-DMA1-59, 06-DMA2-60)	2	
Department for Workforce Investment (06-DWI8-61, 06-DWI19-62)	2	
Justice Cabinet (06-JUST1-63, 06-JUST2-64)	2	
Kentucky Higher Education Assistance Authority (06-KHEAA1-65, 06-KHEAA2-66)	2	
Kentucky Higher Education Student Loan Corporation (06-KHESLC1-67)	1	
Transportation Cabinet (06-TC12-68, 06-TC13-69)	2	

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 1 - SUMMARY OF AUDITOR'S RESULTS (CONTINUED)**

**Federal Awards and Schedule of Expenditures of Federal Awards (Continued)**

Schedule of Expenditures of Federal Awards: We issued a qualified opinion on the Commonwealth's Schedule of Expenditures of Federal Awards because of the effect of the application of a different basis of accounting that is not in conformity with accounting principles generally accepted in the United States of America as described in Note 1 of the schedule. The opinion was issued in relation to the basic financial statements of the Commonwealth taken as a whole.

**Identification of Major Programs**

The following is a list of major Type A programs:

CFDA #    Program Title

**Child Nutrition Cluster:**

10.553	School Breakfast Program
10.555	National School Lunch Program
10.556	Special Milk Program for Children
10.559	Summer Food Service Program for Children

10.558	Child and Adult Care Food Program
10.766	Community Facilities Loans and Grants

11.550	Public Telecommunications Facilities Planning and Construction
--------	--

14.117	Mortgage Insurance-Homes
14.228	Community Development Block Grants/State's Program
14.239	HOME Investment Partnerships Program

17.225	Unemployment Insurance
--------	------------------------

**Workforce Investment Act Cluster:**

17.258	WIA Adult Program
17.259	WIA Youth Activities
17.260	WIA Dislocated Workers

**Highway Planning and Construction Cluster:**

20.205	Highway Planning and Construction
--------	-----------------------------------

64.114	Veterans Housing - Guaranteed and Insured Loans
--------	---

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 1 - SUMMARY OF AUDITOR'S RESULTS (CONTINUED)**

**Federal Awards and Schedule of Expenditures of Federal Awards (Continued)**

**Identification of Major Programs (Continued)**

The following is a list of major Type A programs (Continued):

CFDA #	Program Title
66.458	Capitalization Grants for Clean Water State Revolving Funds
66.468	Capitalization Grants for Drinking Water State Revolving Funds
84.010	Title I Grants to Local Educational Agencies
Special Education Cluster:	
84.027	Special Education Grants to States
84.173	Special Education Preschool Grants
Student Financial Assistance Programs Cluster:	
84.032	Federal Family Education Loans
93.558	Temporary Assistance for Needy Families
93.563	Child Support Enforcement
93.659	Adoption Assistance
93.667	Social Services Block Grant
Medicaid Cluster:	
93.775	State Medicaid Fraud Control Units
93.777	State Survey and Certification of Health Care Providers and Suppliers
93.778	Medical Assistance Program
Disability Insurance/SSI Cluster:	
96.001	Social Security-Disability Insurance
Homeland Security Cluster:	
97.004	State Domestic Preparedness Equipment Support Program
97.067	Homeland Security Grant Program

The following is a list of major Type B programs:

CFDA #	Program Title
10.550	Food Donation
12.401	National Guard Military Operations and Maintenance (O & M) Projects

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 1 - SUMMARY OF AUDITOR'S RESULTS (CONTINUED)**

**Federal Awards and Schedule of Expenditures of Federal Awards (Continued)**

**Identification of Major Programs (Continued)**

The following is a list of major Type B programs (Continued):

CFDA #	Program Title
--------	---------------

Fish and Wildlife Cluster:	
----------------------------	--

15.605	Sport Fish Restoration
--------	------------------------

15.611	Wildlife Restoration
--------	----------------------

16.575	Crime Victim Assistance
--------	-------------------------

16.579	Byrne Formula Grant Program
--------	-----------------------------

Federal Transit Cluster:	
--------------------------	--

20.500	Federal Transit Capital Investment Grants
--------	---

20.507	Federal Transit Formula Grants
--------	--------------------------------

84.357	Reading First State Grants
--------	----------------------------

84.358	Rural Education
--------	-----------------

97.036	Public Assistance Grants
--------	--------------------------

**Dollar Threshold Used to Distinguish Between Type A and Type B Programs**

The maximum dollar threshold used to distinguish between Type A and Type B Programs was \$20 million. Certain component units and agencies audited by Certified Public Accountant (CPA) firms had lower dollar thresholds.

**Auditee Risk**

The Commonwealth did not qualify as a low-risk auditee.



**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

***Reportable Conditions Relating to Internal Controls and/or  
Reportable Instances of Noncompliance:***

**FINDING 06-CHFS1-1: The Cabinet For Health And Family Services Should  
Strengthen The Security Of System Accounts**

---

State Agency: Cabinet for Health and Family Services

During the security vulnerability assessments for FY 06 for machines controlled by the Cabinet for Health and Family Services (CHFS), our examination revealed various system user accounts with password ages that exceeded the established password policy. Additionally we noted several guest accounts that had not been disabled.

We obtained NetBIOS account information from five (5) CHFS machines, three (3) of which were identified during the prior year audit. To determine if user accounts on these machines were in compliance with established policies, the auditor used the criterion that account passwords with ages over 31 days were non-compliant. Of the 108 active Administrator level accounts reviewed among these five (5) machines, there were 61 accounts, or 56.5 percent, with a password age of 32 to 1,667 days and 41 accounts, or 38 percent, which indicate they have never been used to log into the system. Further, of the 3,997 active user accounts reviewed, there were 2,250 accounts, or 56.3 percent, that had never been used to log into the system and 1,013 accounts, or 25.3 percent, with a password age of 32 to 1,995 days.

In addition, seven (7) out of eight (8) guest accounts, or 87.5 percent, had never been used to log into the system; the remaining guest account had a password age of 1,301 days. During FY 05, it was noted that one of these accounts was established on a scanner, which provided various information about the scanner and locations of reports. While this information was not provided during the current review, the account was still noted as non-compliant with the agency established security policy. Further, two of these active guest accounts had not been renamed from the default.

As was noted within our audits for the past two (2) years, comments were viewable concerning four (4) machines that included data that appears to be the last four digits of the user's social security number (SSN). If an account identifier is required then something other than the user's SSN should be used.

The use of default accounts, lax enforcement of the agency's established password policy, or the existence of unused accounts increases the likelihood that accounts could be compromised, as well as the underlying data accessible by those accounts. Providing personal information to anonymous or unauthorized users increases liability that could occur should an unauthorized user obtain that information.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-CHFS1-1: The Cabinet For Health And Family Services Should Strengthen The Security Of System Accounts (Continued)**

---

Intruders often use inactive or default accounts to break into a network. If an account has not been used for a reasonable period of time, the account should be disabled until it is needed. This minimizes the possibility that an unauthorized user will access the account. An account should be deleted if it is not going to be reinstated. Personal data should not be readily available. Established password policies should be consistently applied and enforced.

**Recommendation**

We recommend CHFS review all user accounts on all machines to determine which accounts are not in compliance with the established security policies. These accounts should be evaluated to determine if they are still valid accounts and are required for a business related purpose. If not, the accounts should be disabled or deleted depending on the necessity of reinstatement of the account.

In addition, the agency should ensure personal information, including social security numbers, are not used to identify an account. Per the agency response to our FY 04 audit, the last four digits of the SSN is used as a security measure when taking action on the individual's account. This procedure is coupled with call back to the individual workstations. However, this process still poses a security risk of providing the personal information to intruders and should be re-evaluated by the agency.

**Management's Response and Corrective Action Plan**

*After review of the accounts in question it was determined that these accounts were in the former Cabinet for Health Services (CHS) and Cabinet for Families and Children (CFC) NT4.0 domains that are no longer active domains. These domains have been combined in to the new CHFS domain with the migration to Active Directory (AD) during the audit period. The remaining domain accounts are currently being migrated to the new domain in the Commonwealth of Kentucky (COT) Foster Domain and slated for completion 10/31/06. Corrective action has been taken to delete all accounts within the old NT4.0 domains with the exception of service accounts needed to run applications still in the old domains. These are all in the process of being converted to AD and will be complete within the near future. Accounts within the former CHS Mental Health Mental Retardation (MHMR) domain still remain due to Health Insurance Portability and Accountability Act (HIPAA) audit requirements. Corrective action has been taken to disable all remaining accounts and delete any account outside the HIPAA audit time period.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-CHFS2-2: The Cabinet For Health And Family Services Should Implement Procedures To Ensure Services Are Received Prior To Paying The Full Contract Amount**

---

State Agency: Cabinet for Health and Family Services

During the audit of CHFS Federal Fund 1200 expenditures for the Medicaid program, we noted a significant noncompliance in contract administration.

On December 16, 2004, CHFS requested permission from FAC to enter into a sole source contract with Artemetrx to provide an interactive web-based support tool that would likely result in Medicaid cost savings. The services to be provided under the contract included help desk support, data transmission, hosting information, and functional changes within the system and the work was to be completed in two (2) stages. The University of Kentucky College of Pharmacy previously provided these services to CHFS. Based on the documentation provided, the effective date of the contract was January 19, 2005 and the contract was to expire on August 31, 2005. On January 24, 2005, Artemetrx billed CHFS for the entire contract amount of \$1,000,000. While an invoice was approved by CHFS and payment was authorized on February 1, 2005, the invoice provided to the auditor did not include sufficient detail to determine what services were actually provided.

CHFS continued to work with Artemetrx after the payment date and requested changes throughout the contract period; however, CHFS did not renew the contract. Under the terms of the contract, Artemetrx was to be paid upon successful completion and acceptance of the described work. The contract did not provide for any interim, partial payments, or amounts to be paid upon completion of the work.

We question whether, in only three (3) business days, Artemetrx provided services to CHFS commensurate with the \$1,000,000 in Federal funds that was paid to the contractor. Based on the invoice provided and through inquiries with various agency personnel, we could not determine if the deliverables due under the contract were fully provided to CHFS or if they met the satisfaction of CHFS as specified in the provisions at the time of payment.

The practice of state agencies making full or partial payments on contracts before services are actually rendered is prohibited by section three (3) of the Kentucky Constitution, as addressed in an Attorney General's Opinion, OAG 79-448.

Finance policies at FAP 110-10-00 state that bills should be paid within 30 working days of either the receipt of correct invoice, or receipt of goods or services in satisfactory condition.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-CHFS2-2: The Cabinet For Health And Family Services Should Implement Procedures To Ensure Services Are Received Prior To Paying The Full Contract Amount (Continued)**

---

The contract provisions state that, "Payments are predicated upon successful completion and acceptance, by the Commonwealth, of the described work, services, supplies, or commodities, and delivery of the required documentation. Invoices for payment shall be submitted to the Agency Contact Person or his/her representative."

OMB Circular A-87 states, "Governmental units are responsible for the efficient and effective administration of Federal awards through the application of sound management practices." A-87 further states, "for costs to be allowable under Federal awards, costs must not be prohibited under state or local laws or regulations...and, be adequately documented."

OMB Circular A-133 Compliance Supplement – Part 6 on internal control over Federal awards requires state agencies to monitor and document contractor performance with the terms, conditions, and specifications of the contract. Management should conduct independent reviews of procurements and contracting activities to determine whether policies and procedures are being followed as intended. Procedures should be sufficient to identify risks arising from vendor inadequacy.

Good internal controls require expenditures to be supported with adequate documentation before approval at each level.

**Recommendation**

CHFS should have either delayed payment until the contract services were fully rendered, or amended the contract to provide for partial payments based on clearly defined deliverables and services which had actually been received. We recommend CHFS re-evaluate the contract monitoring process and implement controls to ensure similar situations do not occur.

**Management's Response and Corrective Action Plan**

*The Department is in the process of reviewing and upgrading its contract monitoring processes and procedures. A contract monitoring focus group has been installed within the Commissioner's office. There is currently one employee hired (an attorney by training) and a second employee is being transferred into the Commissioner's Office to also assist the Medicaid Divisions with monitoring. The latter employee has extensive training on the new State Accounting System (E-MARS). Program monitoring changes will include controls to ensure that*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-CHFS2-2: The Cabinet For Health And Family Services Should Implement Procedures To Ensure Services Are Received Prior To Paying The Full Contract Amount (Continued)**

---

**Management's Response and Corrective Action Plan (Continued)**

*contract payments are not made until a documented deliverable has been received, reviewed, and approved. We agree that in this particular contract the payment terms did not adequately define the payment terms that the department had intended for this vendor and we will take steps to alleviate these ambiguities in the terms and conditions attached to future and current contracts.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-CHFS3-3: The Cabinet For Health And Family Services Should Strengthen Controls Over The Processing Of Vendor Payments**

---

State Agency: Cabinet for Health and Family Services

While testing expenditures of CHFS, significant delays between the invoice date and paid date were noted within the Department of Mental Health Mental Retardation (MHMR). To determine the extent of the problem, auditors requested original documentation of payments made to vendors from Hazelwood Center, the facility where the majority of the problems were noticed. Of the 15 invoices tested at Hazelwood, problems were noted with each.

- Lack of supporting documentation

Supporting documentation is not always obtained prior to paying an invoice. Invoices are sent to various offices on the Hazelwood campus, or left with goods as they are delivered instead of being sent directly to the accounting department. Ten (10) of the invoices viewed were faxed to the facility and the original invoices were not available. In some instances, the original invoices may have been misplaced or not retained for the appropriate length of time. Six (6) of the 15 invoices were not accompanied by a receiving report. Invoices did not always have a "Received" stamp, showing the date the invoice was received in the business office. One instance was noted of a payment being sent to the wrong vendor. That vendor credited the facility's account and did not issue a refund of the amount paid in error. Payment was then made to the correct vendor, causing a duplicate payment for the same invoice. Poor record keeping, employee turnover, and inadequate communication between MHMR and Hazelwood may contribute to the problems in the accounting office. Without sufficient documentation, the facility could be making duplicate payments or paying the incorrect amount to vendors. If the receiving report is not reviewed, the state could be paying for goods not received.

Finance and Administration Policy (FAP 110-10):

**SELLER'S INVOICES:** Invoices, if required, shall be prepared and transmitted to the agency receiving the goods or services. One copy shall be marked "original" unless otherwise specified.

- Timely Payment

Accounting personnel do not always receive a copy of the original invoice. Eight (8) of the items included past due amounts or were marked FINAL BILL. An

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-CHFS3-3: The Cabinet For Health And Family Services Should Strengthen Controls Over The Processing Of Vendor Payments (Continued)**

---

explanation of what happened to the previous bills could not be provided. Accounting personnel may not be aware of FAC policies governing vendor payments. This could lead to vendors deciding not to do business with the state because of the difficulty in receiving payments. Any early payment discounts are not taken advantage of if payments are not made timely. Additional charges may be assessed for late payments.

Finance and Administration Policy (FAP 110-10):

**TERMS FOR PROMPT PAYMENT:** A bill shall be paid within 30 working days of either the receipt of correct invoice, or receipt of goods or services in satisfactory condition. A penalty payment of one percent (1%) per month shall be added to the amount due the vendor for each full or partial month that the payment exceeds 30 working days. As an incentive for earlier payment, bidders for state contracts are encouraged to offer discounts for payments made in less than the prescribed 30 days.

(FAP 120-05):

The originating agency shall in ten working days:  
Process the document to acceptance.

(FAP 111-45):

The original vendor invoice, if required, shall be retained in the agency for the period of time required by the appropriate document retention schedule. The invoice shall be on the official invoice form of the vendor.

(FAP 120-21):

An agency shall maintain the original source document that initiated a transaction and shall maintain a system of tracking that allows for auditing the original source document back to the electronic system.

- **Coding Error**

One (1) expenditure for \$343 was recorded in MARS as E256, Garbage Collection. The corresponding invoice showed pagers were purchased. The \$343 should have been charged to E265, Paging Services.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-CHFS3-3: The Cabinet For Health And Family Services Should Strengthen Controls Over The Processing Of Vendor Payments (Continued)**

---

Accounting personnel have not always been properly trained in entering information into MARS. There may not be proper review over the processing of expenditure payments. Miscoding expenditures in MARS causes numerous problems when tracking the amount spent in each expenditure area. This could cause Financial Statements and reports to be misstated.

Finance and Administration Policy (FAP 120-19):

**AGENCY RESPONSIBILITY FOR ACCURATE USE OF EXPENDITURES OBJECT CODES:** Payments classified with objects that are potentially 1099 reportable shall be reviewed by agencies to insure correct classification of expenditures involving both services and materials.

**Recommendation**

We recommend the following:

**Lack of Supporting Documentation**

- o Retain all original invoices.
- o Document payments made to vendors to ensure duplicate payments are not being made.
- o Implement procedures to monitor payment processes at state run facilities.
- o Require vendors and/or staff to send invoices directly to the accounting office.
- o Require staff to forward all receiving reports to the accounting office and make payments on invoices only after they are reviewed.

**Timely Payment**

- o Make payments to vendors in a timely manner.
- o Take advantage discounts offered for on-time payments

**Coding Error**

- o Provide training on entering information into MARS to the accounting staff of MH/MR facilities.



**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-CHFS3-3: The Cabinet For Health And Family Services Should Strengthen Controls Over The Processing Of Vendor Payments (Continued)**

---

**Management's Response and Corrective Action Plan**

*On December 12, 2006, a meeting was held to discuss the above audit findings made by the Auditor of Public Accounts (APA). Personnel attending this meeting included representatives from the APA, the Department for Mental Health and Mental Retardation Services (DMH-MRS), and the Cabinet for Health and Family Services central office accounting staff. The meeting was held at the request of DMH-MRS to discuss the audit findings and clarify questions concerning the audit of State Fiscal Year 2006 operations. DMH-MRS was provided working papers by the auditors along with explanations of the audit findings.*

*From that meeting, DMH-MRS understands the findings and subsequent "Record of Control Weakness" are related to our Hazelwood Center operations only. While the audit report indicates other possible instances, the audit findings are based upon fifteen Hazelwood invoices only and where the majority of problems occurred according to the report. Therefore, DMH-MRS bases our response solely on those fifteen invoices and operations at Hazelwood Center.*

*From the meeting with APA staff, DMH-MRS understands that the fifteen invoices represent an entire universe of transactions being defined by the lag in payment date compared to the received date of the goods or services. The total of these questioned invoices is \$11,864.35 with total Hazelwood Center expenditures amounting to \$35,293,615 for the fiscal period. The percentage of questioned invoices to total expenditures yields a rate of occurrence of approximately one-third of one percent. In regard to the audit findings, DMH-MRS has weighted the possible exposures and risks along with this rate of occurrence and the fact that said transactions are part of a known universe. If such transactions were expected to occur at even a marginal rate of occurrence across the entire Department's operations, we would very likely present a different plan of action than the one contained herein.*

*The audit demonstrates that some accounting documents are not reaching the appropriate staff at Hazelwood Center for processing. This could result from several reasons such as the vendors failing to bill us, failure of receiving Departments to transmit documents to the Business Office, loss of documents in the Business Office, etc. Furthermore, Hazelwood Center did not have mitigating controls sufficient to prevent or reveal such incidences during the audit period. The cause of these bills not being paid timely primarily results from documents not reaching the Business Office in DMH-MRS' estimation.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-CHFS3-3: The Cabinet For Health And Family Services Should Strengthen Controls Over The Processing Of Vendor Payments (Continued)**

---

**Management's Response and Corrective Action Plan (Continued)**

*Some of the fifteen invoices referenced might be justified given individual circumstances involving those payments. However, we accept the audit's general premise that all accounting documents need to be protected, retained, and monitored in such a way as to limit some occurrences contained within the group of fifteen. DMH-MRS is unsure what the APA is referring to concerning the comment of "inadequate communication between MH/MR and Hazelwood" possibly contributing to problems.*

*Based upon the findings of the audit, Hazelwood Center plans to implement operating changes that include hiring a reception/clerical person, training existing staff on established policies, and developing policies to strengthen controls in certain aspects of the operation as contained below:*

- Hire a receptionist/clerical position that has been vacant in the Business Office. This person will initially receive accounting documents routed to the Business Office and make sure that appropriate stamps have been applied. Also, the position will monitor a process to be developed for documents awaiting an invoice including a review every 15 days and follow-up with vendors on all outstanding issues at each review interval.*
- Purchase additional date stamps as contained in FAP 120-05-00.*
- Implement procedures for receiving and payments of goods/services consistent with the Commonwealth's procurement policies and especially addressing routing of documents and documenting receipt of goods/services.*
- Develop facility policy concerning vendor contacts including documentation requirements and retention issues.*
- All facility personnel involved in purchasing, receiving and payments shall be scheduled for appropriate training within the next 30 days.*
- Develop an internal review process scheduled on a routine basis to review operations for compliance with facility procedures.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-CHFS3-3: The Cabinet For Health And Family Services Should Strengthen Controls Over The Processing Of Vendor Payments (Continued)**

---

**Management's Response and Corrective Action Plan (Continued)**

*We will forward copies of all Hazelwood policies and procedures implemented as a result of this audit to the APA no later than March 1, 2007. The Fiscal Officer at Hazelwood Center is the contact person for implementing recommendation issues.*

*In regard to the APA's recommendations, we generally find them supported by the work performed, appropriate, and to be in accordance with the Commonwealth's procurement policies and procedures. Furthermore, we agree to implement the recommendations except for a couple of instances where DMH-MRS does not reconcile audit work performed with the recommendations made. Under the section titled "Lack of Supporting Documentation", a recommendation is contained to implement procedures for monitoring payment processes at state run facilities. As stated above, Hazelwood will implement a review of open items along with developing an internal review process. The findings do not indicate to DMH-MRS any need to look at other facilities or processes contained in the Cabinet. Each DMH-MRS Business Office is operated independently of the other facilities making the extension of this finding to other facilities appear inappropriate based upon the level of testing performed. In regard to the "Coding Error" recommendation, this is the same situation as the previously discussed item with each facility being independent. Also, we believe that Hazelwood's coding is appropriate and that the cited error is nothing more than a key stroke error from E256 instead of E265 and does not result from a lack of training or design weakness in the system. DMH-MRS strives to keep such instances to a minimum, but such errors are inherent in the work performed. DMH-MRS would not see the isolated example cited above as an indication of systematic concern. Not all staff in the Business Office would perform coding functions given appropriate segregation of duties in the procurement process. Hazelwood staff will review coding procedures with appropriate staff and continue to monitor payments for correct coding.*

**Auditor's Reply**

For clarification, the comment on "inadequate communication between MHMR and Hazelwood" referenced that Hazelwood personnel were not aware of the appropriate date to enter in MARS-the date of the invoice, the date the invoice was received, or the date the invoice was paid. MHMR, according to the

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-CHFS3-3: The Cabinet For Health And Family Services Should  
Strengthen Controls Over The Processing Of Vendor Payments (Continued)**

---

**Auditor's Reply (Continued)**

information provided to the auditor, did not provide guidance on this issue to Hazelwood personnel.

Although the auditor noted invoice problems at the Hazelwood facility, CHFS may benefit from reviewing procedures in other facilities to ensure payment processes are operating effectively.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-CHFS4-4: The Cabinet For Health And Family Services Should Maintain Adequate Documentation For Contract/Vendor Payments**

---

State Agency: Cabinet for Health and Family Services

During the audit of CHFS, concerns were noted in internal controls over the processing of capital project expenditures. Payments to contractors for work performed were not supported by adequate documentation. Specifically:

- Authorizations for expenditures were rubber stamped with no date, so it is unclear to the auditor as to the date the approval was made on CHFS Receiving Reports and Authorization for Payment forms.
- Vendor invoices totaling \$13,779 were changed by CHFS with no explanation or support as to what caused the changes, due to agency and vendor disagreement over pricing.
- Contract renegotiations, were not put in writing or explained to and agreed-upon by the vendor.

The cause of the above problems include:

- Invoices were not always stamped with the date received.
- Changes in invoice amounts were made on the invoice, but no explanation for the change was documented.
- Vendors may be performing work before the contract terms have been negotiated and agreed-upon.

As a result of these problems, payments may not be made timely and Kentucky could lose out on any early payment discounts.

Kentucky could be paying for work that has not been completed or paying a higher than necessary rate to avoid vendor disputes. If terms are not agreed-upon in writing, either party could claim to have been uninformed as to the terms of the agreement and vendor relations and quality of service could be compromised or disputed.

Finance policies at FAP 110-10-00 state that bills should be paid within 30 working days of either the receipt of correct invoice, or receipt of goods or services in satisfactory condition.

Good internal controls dictate that any reasons for changes to invoices be documented. Also, FAP 120-21 states, "An agency shall maintain the original source document that initiated a transaction and shall maintain a system of tracking that allows for auditing the original source document back to the electronic system."

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-CHFS4-4: The Cabinet For Health And Family Services Should Maintain Adequate Documentation For Contract/Vendor Payments (Continued)**

---

The practice of state agencies making full or partial payments on contracts before services are actually rendered is prohibited by section three (3) of the Kentucky Constitution, as addressed in an Attorney General's Opinion, OAG 79-448.

**Recommendation**

We recommend the following:

- CHFS stamp all invoices with the date received.
- All supporting documentation and invoices for work performed by a vendor should be retained by CHFS and any changes to invoices documented.
- Contract payments should be closely monitored and reviewed before payment is made. Both parties should agree upon contract terms before work is performed. Contract terms should be followed by agency personnel and changes made through signed modifications only.

**Management's Response and Corrective Action Plan**

- *CHFS stamp all invoices with the date received.*
  - *As of July invoices are time stamped with the date and person that received the invoice.*
- *All supporting documentation and invoices for work performed by a vendor should be retained by CHFS and any changes to invoices documented.*
  - *In this case the vendor was notified of the error and an agreement was struck. This agreement was not documented however the contract was modified with the knowledge of the vendor who was carbon copied by email dated September 30, 2005.*
  - *As of this RCW, measures have been established to ensure no changes occur to vendor timesheets or invoices. In this instance, the contracts should have been modified to the correct amounts invoiced and then after the payments were made changed back to the correct agreed upon amount or the contractor should have re-invoiced at the corrected amount.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-CHFS4-4: The Cabinet For Health And Family Services Should  
Maintain Adequate Documentation For Contract/Vendor Payments (Continued)**

---

**Management's Response and Corrective Action Plan (Continued)**

- *Contract payments should be closely monitored and reviewed before payment is made. Both parties should agree upon contract terms before work is performed. Contract terms should be followed by agency personnel and changes made through signed modifications only.*
- *The final recommendation is duly noted and procedures to this effect have been reinforced.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-CHFS5-5: The Cabinet For Health And Family Services Should Strengthen Controls Over The Processing Of Contract Payments**

---

State Agency: Cabinet for Health and Family Services

During the audit of CHFS' Department for Medicaid Services (DMS), we met with various personnel and reviewed a list of contracts. It came to our attention that the contract monitoring process did not adequately track payments made on contracts. DMS enters into contracts with vendors who administer various parts of the Medicaid program. The vendors process and substantiate Medicaid claims and distribute payments to doctors, hospitals and pharmacies. More than \$5 billion is expended annually through the Medicaid program; around \$3 billion of this is Federal money, \$2 billion paid by the state of Kentucky. Specific problems noted were:

- Personnel responsible for paying invoices had to wait a long time on personnel responsible for approving invoices.
- Personnel responsible for approving invoices would change the invoice amount but fail to document the reason for the change.
- No tracking system was in place to monitor contract payments to the entire contract amount to ensure overpayments or underpayments did not occur. For example, one contractor had been paid twice for the same invoice. This went undetected by DMS until the vendor notified them of the error.
- Also, there are no written guidelines relating to the tracking of contracts and invoice payment process. Expenditures are coded to different object codes depending on the person entering the data. A consistent method of entering data does not appear to exist.
- Auditor inquiries regarding comparison of prior year expenditures were not addressed by the agency. The agency failed to provide explanations for significant increases in "Miscellaneous" and "Other Benefits" expenditure categories.

The invoice payment process was not efficient and the contract monitoring process was not adequate. Guidelines on monitoring contracts and data input are not consistently applied. Procedures for invoice payment and contract monitoring are inconsistent and not written down. We do not know why our requests for variance explanations went unanswered.

Vendors were not paid timely. As a result, duplicate payments, overpayments, and underpayments could go undetected. There were large variances in amounts paid on contracts, depending on the person reviewing it. Expenditures to vendors and payments made on contracts are hard to determine.



**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-CHFS5-5: The Cabinet For Health And Family Services Should Strengthen Controls Over The Processing Of Contract Payments (Continued)**

---

Good internal controls dictate policies be consistently applied and adequate documentation be maintained. Documentation should be retained for a minimum of three (3) years and payments to contractors should be consistently reviewed to avoid mistakes.

**Recommendation**

The auditor noted DMS recognized some of the weaknesses above during FY 07 and has already begun implementing changes. A new position has been created for contract monitoring. Persons responsible for approving invoices have been given a 5-day turn around time limit.

We recommend DMS continue to review and improve the contract monitoring process. Also, DMS should provide written guidelines related to invoice review, authorization, timely payment, and data input. DMS should track invoices against contracts to ensure the appropriate amount is paid and duplicate payments do not occur.

**Management's Response and Corrective Action Plan**

*As DMS representatives indicated to the State Auditors when they were here, DMS recognized the need for controls and had already begun working on implementing change when the Auditors arrived.*

*Since a new Commissioner has been in the Department, the following changes have been or are in the process of being implemented:*

- 1) A Director of Contract Oversight has been hired whose responsibilities include reviewing and drafting Request for Proposals (RFPs), contracts, scope of works for more detailed deliverables and accountability; assisting program areas with corrective action plans, developing Department processes and procedures for contract monitoring.*
- 2) A lead Contract Monitor is in the process of being hired whose responsibilities will include training staff to create monitoring tools, assisting with creating corrective action plans, developing and tracking monitoring reports, tracking and analyzing monitoring data for management, setting contract tracking deadlines; providing statistical analysis to management staff as well as contractors; create and manage spreadsheets related to contract monitoring.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-CHFS5-5: The Cabinet For Health And Family Services Should Strengthen Controls Over The Processing Of Contract Payments (Continued)**

---

**Management's Response and Corrective Action Plan (Continued)**

- 3) *All DMS contracts are being reviewed to ensure that the person(s) assigned to administer the contract are in charge of the program(s) responsible for monitoring the contract.*
- 4) *DMS is developing written Invoice Processing Procedures for the department that will look somewhat like the following:*

***DMS Invoice Processing Procedures***

1. *Unless counsel for CHFS prohibits, all DMS contracts entered into after the effective date of this procedure shall contain a provision similar to the following: "Contractor shall submit a monthly invoice for payment for services to the DMS Financial Management Branch(FMB), Department for Medicaid Services, 275 E. Main Street, 6W-C, Frankfort, KY, 40621, in a form prescribed or approved by DMS. The invoice shall not be submitted before the end of the month in which services were rendered or deliverables approved."*
2. *All invoices shall be dated and logged into the DMS invoice tracking system by the Financial Management Branch upon receipt.*
3. *The FMB shall monitor contract payments in relation to the budgeted contract amount to ensure that overpayments or underpayments do not occur. FMB shall forward monthly contract status reports to all Division Directors and the Commissioner's Office.*
4. *Should an invoice submitted for payment be sent directly to an area outside of the FMB, it shall immediately be forwarded to the FMB.*
5. *A copy of the invoice and any attachments shall be forwarded to the appropriate Division Director within three (3) business days of receipt by FMB for authorization prior to processing.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-CHFS5-5: The Cabinet For Health And Family Services Should Strengthen Controls Over The Processing Of Contract Payments (Continued)**

---

**Management's Response and Corrective Action Plan (Continued)**

6. *It is the responsibility of the Division Director to verify the correctness of the invoice, including that the services, deliverables, materials and/or equipment have been received in good order and that the service or deliverables have been completed pursuant to the contract terms. The Division Director shall retain and be familiar with the most recent applicable contract, any modifications, and its terms.*
7. *If and when verification has been made that services, deliverables, materials and/or equipment have been received in good order and pursuant to the contract terms, the original invoice, if correct in all respects, shall be approved for payment by the Division Director and returned to FMB within ten (10) business days of receipt. The invoice must be signed and dated by the Division Director and include their printed name.*
8. *If the Division Director alters the invoice amount to be paid, the Division Director shall document the reason for the change. Any invoice on which the amount has been changed but has been submitted to the FMB without documentation shall be returned unpaid to the Division Director by the FM.*
9. *Divisions shall notify both the Commissioner's Office and the FMB of any issues surrounding invoices that cannot be resolved prior to the ten (10) business day deadline from expiring.*
10. *The FMB shall notify both the Division Director and the Commissioner's Office via email of any invoices that have not been approved for payment on the eleventh (11th ) business day.*
11. *Invoices for the MMIS, KMAA, and the PBA contracts shall be reviewed for payment by the DMS Invoice Committee consisting of the Pharmacy Benefits Director, the Division of Administrative and Financial Affairs Director, the Division of Medical Management & Quality Assurance Director, the Division of Claims Management Director, the Division of Long Term Care & Community Alternative Director, the Division of Hospital & Provider Operations Director, and the OIT Project Managers.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-CHFS5-5: The Cabinet For Health And Family Services Should Strengthen Controls Over The Processing Of Contract Payments (Continued)**

---

**Management's Response and Corrective Action Plan (Continued)**

- a. The DMS Invoice Committee shall meet twice monthly or as needed.*
- b. The DMS Invoice Committee shall follow the procedures set forth in paragraphs 1-10 in reviewing invoices.*
- c. The DMS Invoice Committee shall elect a Committee chair at least yearly to conduct the invoice meetings, sign invoices on behalf of the Committee, and ensure that the procedures set forth above are followed.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-CHFS6-6: The Cabinet For Health And Family Services Should Obtain A SAS 70 Audit**

---

State Agency: Cabinet for Health and Family Services

During the audit of CHFS, we noted that not all CHFS contracts with service organizations required a Statement on Auditing Standards 70 (SAS 70) audit. Since CHFS has contracts with multiple service organizations, which process and handle millions of dollars and transactions at any given time, each contract should include provisions requiring a SAS 70 audit to ensure controls are operating effectively, efficiently, and reliably.

From July 2005 thru May 2006, Tier Technologies, a Service Organization contracted with CHFS, processed \$268,053,376 out of a total of \$342,315,872 for Child Support or 78% of all CSE payments for a 11 month period.

The lack of a SAS 70 audit denies CHFS valuable information on service organizations controls and effectiveness. When SAS 70's are performed, CHFS would receive a detailed report describing the service organizations controls, along with an independent assessment of whether these controls were placed in operation, suitably designed, and operating effectively. Without the SAS 70 audits, CHFS does not have assurance that control activities and control objectives are being met at each service organization.

Statement on Auditing Standards 70 defines a service organization as—"The entity (or segment of an entity) that provides services to a user organization that are part of the user organization's information system."

Statement on Auditing Standards 70 states, "service organizations that provide such services include application service providers that provide packaged software applications and a technology environment that enables customers to process financial and operational transactions. The guidance in this section may also be relevant to situations in which an organization develops, provides, and maintains the software used by client organizations."

"Statement on Auditing Standards (SAS) No. 70, Service Organizations, is an internationally recognized auditing standard developed by the American Institute of Certified Public Accountants (AICPA). A SAS 70 audit or service auditor's examination is widely recognized, because it represents that a service organization has been through an in-depth audit of their control activities, which generally include controls over information technology and related processes. SAS No. 70 is the authoritative guidance

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-CHFS6-6: The Cabinet For Health And Family Services Should Obtain A SAS 70 Audit (Continued)**

---

that allows service organizations to disclose their control activities and processes to their customers and their customers' auditors in a uniform reporting format." <http://www.sas70.com/about.htm>.

"In addition, the requirements of Section 404 of the Sarbanes-Oxley Act of 2002 make SAS 70 audit reports even more important to the process of reporting on effective internal controls at service organizations," as the website states: <http://www.sas70.com/about.htm>.

**Recommendation**

We recommend CHFS require a SAS 70 audit for all contracts with service organizations going forward. This requirement will not only benefit CHFS, but would provide feedback on the controls and activities of the service organization, and demonstrate CHFS is committed to ensuring all transactions and monies are handled in a safe, secure, efficient manner.

**Management's Response and Corrective Action Plan**

*The Cabinet for Health and Family Services agrees that including a SAS 70 audit requirement in the contract for Child Support Collections is appropriate. The CHFS is currently drafting a Request for Proposal for a new contract for Child Support Collections and will include a requirement for a SAS 70 audit in the RFP and the resulting contract.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-DEI1-7: The Department Of Employee Insurance Should Ensure All Public Funds On Deposit Are Secured**

---

State Agency: Department of Employee Insurance

According to KRS 66.480(1)(d) and KRS 41.240(4), the depository institution should pledge or provide sufficient collateral which, together with Federal Deposit Insurance Corporation insurance, equals or exceeds the amount of public funds on deposit at all times. The Plan's deposits of public funds in depository institutions were uninsured and unsecured. The Plan has uninsured and unsecured deposits over FDIC limits.

At June 30, 2006, \$26,198,581 of the Plan's deposits of public funds in depository institutions were uninsured and unsecured.

**Recommendation**

We recommend that the Plan require the depository institution to pledge or provide collateral in an amount sufficient to secure deposits of public funds at all times.

**Management's Response and Corrective Action Plan**

*The Department of Employee Insurance (DEI) management agrees with the recommendation to secure all public funds on deposit for operating the Plan. These funds are on deposit in two National City Treasury Management accounts which include the electronic transfers to an escrow account and those funds deposited by checks to a lockbox for premium payments from school boards, health departments, and some local governments. Plan funds are currently swept in to overnight investments for a higher rate of interest and returned the next business day. However, the investments do not meet the statutory requirements for state investment, so the Personnel Cabinet has asked the Office of Financial Management in the Finance and Administration Cabinet to make arrangements with National City Bank and Humana to invest the funds into money market instruments that will be in compliance.*

*In advance of this review, management has changed procedures, effective January 2, 2007, such that funds will be transferred as each check is issued rather than when each check is presented to the bank. This will eliminate the need to advance state funds to Humana and effectively will move investment funds to the state depository and solve the problem. We will continue to require an overnight sweep of the funds on deposit to the advantage of the Commonwealth.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-DOC1-8: The Department Of Corrections Should Strengthen Logical Security Procedures Surrounding The ORION Application**

---

State Agency: Department of Corrections

During our audit of the logical security controls for the Offender Records Information Operations Network (ORION), we determined that the Department of Corrections (DOC) did not adequately secure access to ORION.

ORION access requests are submitted differently depending upon the user location. Specifically, the county jail users are responsible for completing an ORION Local Jail User Agreement and Application for ORION User Account. On the other hand, DOC central office supervisors request access on behalf of their employees via a service request within the HelpBox Enterprise SQL application. The service request is an automated form that is used to request repairs, research, installations, orders, and account setup. When used as an account setup request, the access request form includes the submitter's name, employee name, requested user name, and access level required.

Our audit identified the following issues concerning DOC access controls for ORION:

- DOC had not developed formal policies and procedures to govern access controls for ORION. As a result, DOC central office users have not been required to sign-off on their rights and responsibilities with respect to the confidentiality of the ORION system usage, and formal procedures for requesting and granting access were not developed.
- DOC-central office ORION access requests are not being consistently processed and tracked through HelpBox Enterprise SQL. Discussions revealed that access requests are occasionally fulfilled through verbal or e-mail requests. This bypasses the established, albeit not formalized, procedures for tracking and fulfilling requests through the HelpBox application.
- We tested all seven user accounts with greater than READ access to the ORION Offender Security Information (OSI) screen. Four of these were legitimate ORION administrators but there were no authorizing service request forms on file for these users. Two additional administrator accounts were shared by these same four administrators noted above. One account belonged to an employee that transferred out of the office in October 2004 and still had delete capabilities to this screen.



**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-DOC1-8: The Department Of Corrections Should Strengthen Logical Security Procedures Surrounding The ORION Application (Continued)**

---

- We reviewed a list of users with greater than READ access to ORION who reside outside of the Justice Cabinet. As a result, we determined that one account belonged to a Commonwealth Office of Technology user and had DELETE access to the Offender Records Information (ORI) screen. Subsequent review indicated that this user had deceased. That account was removed during our fieldwork.
- We tested all six user accounts with greater than READ access to a critical ORION dataset. Our testing revealed that again, all four administrators noted above as accessing the OSI screens shared two of these accounts with administrator level access to this particular ORION dataset. Further, one account belonged to an employee that had terminated employment in March 2005.
- We selected a sample of 67 users with ORION access, which represented approximately five percent of all ORION users. This sample included 64 DOC central office users and 3 local jail users. We noted issues with 58 of the 64 DOC central office user accounts, and with all three of the tested local jail user accounts as follows:
  - Four (4) central office users had ORION security profiles associated with another user. During our fieldwork these profiles were changed to the correct user, yet no service request form was on file for any of these actual users.
  - Thirty-three (33) additional central office users had ORION security profiles but had no service request form.
  - Service request forms were on file to support access for 21 of the sampled central office users with ORION security profiles. However, these forms were incomplete and the missing information included data such as approver (submitter), user ID, and user access level.
  - There were no access request forms on file for any of the three sampled local jail users.
- We identified 33 users with duplicate ORION accounts. Specifically, our testing revealed:
  - Twenty-six (26) users had unnecessary duplicate accounts. During our fieldwork, DOC corrected 22 of these instances, either by deleting the unnecessary account or by re-assigning it to someone else. However, unnecessary duplicate accounts still exist for the remainder.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-DOC1-8: The Department Of Corrections Should Strengthen Logical Security Procedures Surrounding The ORION Application (Continued)**

---

- One user had transferred offices and the user's accounts were re-assigned to generic names.
  - One user had three separate accounts, two of which were used for generic file room accounts. One of these generic file room accounts was deactivated during our fieldwork but one still remains active.
  - Two user accounts were generic user accounts with READ access established for use by Probation & Parole offices. Therefore, use of these accounts would not properly identify the actual user of the system. These accounts remain active.
- In addition to the sampled accounts above, we examined certain attributes of all user accounts for the 31 county jails with ORION access. We found issues with 25 user accounts at 17 of these jails. Those issues were:
- Generic usernames were assigned to 12 accounts. DOC subsequently assigned eleven of these accounts to specific users. However, one account remained as a generic username at the time of our fieldwork.
  - 11 accounts were unused. DOC subsequently removed ten of these accounts and assigned one for a specific user.
  - One profile was assigned to the wrong user ID. This issue was corrected during our fieldwork.
  - One county jail was assigned three user accounts, which violates the Local Jail User Agreement and Application that states there are to be no more than two users per county jail. One of these accounts was removed during our fieldwork

Failure to implement formal information system security policies increases the risk of unauthorized access or modification to computer programs and data, destruction of assets, and interruption of services. Allowing users the ability to access information without proper authorization may subject the processing of data to errors and/or omissions. Unauthorized users may compromise the integrity of data processed through the ORION system. Further, unnecessary accounts increase the risk of unauthorized use or modification of ORION system resources.

Formal policies governing the security administration of a system would provide a security framework to educate management and users of their security responsibilities. To help ensure strong security and integrity of the system data, a formal application level security policy is needed, identifying administrator and user responsibilities concerning

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-DOC1-8: The Department Of Corrections Should Strengthen Logical Security Procedures Surrounding The ORION Application (Continued)**

---

use of this application. The formalized security policies and procedures should identify at a minimum the processes to be followed for adding, modifying or deleting user access. The policies should prevent the sharing of accounts and passwords because such methods do not provide for proper accountability of system transactions. Any formalized policies should be consistently applied.

**Recommendation**

We recommend that DOC take the following corrective actions:

- Develop and implement formal security policies and procedures concerning ORION access. These policies and procedures should address access request procedures and related standard forms to be used, authorization procedures, user and administrator responsibilities, and consequences for policy violations. Established procedures should be consistently applied for all users. Access request forms should be standardized and required to support granted access. These forms should be properly maintained for audit purposes.
- Develop and implement procedures for periodic review of all users with ORION access to ensure proper authorization and the appropriateness for the access level provided.
- This review should include verification that properly authorized access request forms are on file.
- Develop and implement procedures governing notification of employee termination or transfer to ensure that user access to ORION is promptly removed when access to the system is no longer required. All unused accounts should be removed.
- Discontinue the use of generic or shared user accounts, as these do not provide adequate identification of the specific user accessing the system. Therefore, accountability is lost and it becomes difficult or impossible to attribute the actions performed by the account to any specific individual. Controlling the sharing of administrator level accounts is especially of concern as those accounts can be used to alter or delete data or users.

COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-DOC1-8: The Department Of Corrections Should Strengthen Logical Security Procedures Surrounding The ORION Application (Continued)**

---

**Management's Response and Corrective Action Plan**

*We are developing a department-wide policy for data access requests, which will include a signed non-disclosure statement, long with a statement of data access requirements.*

*These request forms will be authorized and submitted by workgroup supervisors level or above for all new hires or new transfers into a work-group.*

*Our department-wide policy will require that all user access accounts be recertified at least annually by the Orion Security Administrator.*

*Our department-wide policy will require that the DOC Division of Personnel provide an Employee Access Revocation Exit form upon an employee's termination.*

*We will develop a department-wide Data Access Request system which will be used to assign, monitor, track, and maintain a historical record of all Data Access activities in the Department. This system will be web-based and have the capability of producing hard copy forms when needed for signature.*

*Our data administrator accounts will be assigned to a Controlling administrator. Data maintenance and administrator accounts will be assigned only as necessary.*

<i>Anticipated completion date:</i>	<i>June 30, 2006</i>
<i>Anticipated Department-wide policy implementation date:</i>	<i>August 30, 2006</i>

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-D0C2-9: Department of Corrections Should Strengthen Logical Security Procedures Surrounding the VINE Application**

---

State Agency: Department of Corrections

During our audit of the logical security controls for the Victim Information and Notification Everyday (VINE) system, we determined that the Department of Corrections (DOC) did not adequately secure access to VINEWatch. VINEWatch is the computer input module within VINE, which allows Corrections personnel the ability to register people for notification of inmate status and enables users to run reports, track usage of the VINE service, and produce notification letters.

Currently, there are five users with update access to VINEWatch. However, there have been no formalized procedures developed governing access to VINEWatch. Additionally, there have been no security forms developed by which to request and authorize access to the system.

Failure to implement formal information system security policies increases the risk of unauthorized access or modification to computer programs and data, destruction of assets, and interruption of services. Allowing users the ability to access information without proper authorization may subject the processing of data to errors and/or omissions. Unauthorized users may compromise the integrity of data processed through the VINE system. Further, unnecessary accounts increase the risk of unauthorized use or modification of VINE system resources.

Formal policies governing the security administration of a system would provide a security framework to educate management and users of their security responsibilities. To help ensure strong security and integrity of the system data, a formal application level security policy is needed, identifying administrator and user responsibilities concerning use of this application.

The formalized security policies and procedures should identify at a minimum the processes to be followed for adding, modifying or deleting user access. The policies should prevent the sharing of accounts and passwords because such methods do not provide for proper accountability of system transactions. Any formalized policies should be consistently applied.

**Recommendation**

We recommend that DOC develop and implement formal security policies and procedures concerning VINE access. These policies and procedures should address access request procedures and related standard forms to be used, authorization

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-DOC2-9: Department of Corrections Should Strengthen Logical Security Procedures Surrounding the VINE Application**

---

**Recommendation (Continued)**

procedures, user and administrator responsibilities, and consequences for policy violations. Established procedures should be consistently applied for all users. Access request forms should be standardized and these forms should be properly maintained to support granted access for audit purposes.

**Management's Response and Corrective Action Plan**

*We propose to develop and implement formal security policies and procedures concerning VINE access including access request procedures and related standard forms in conjunction with the Orion Access Request Forms being developed. We will work to develop administrator responsibilities, and consequences for policy violations. The policies will be consistently applied for all users. Anticipated implementation date: June 30, 2006*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-DOC3-10: The Department of Corrections Should Strengthen The Security Of System Accounts**

---

State Agency: Department of Corrections

During the security vulnerability testing performed for FY 2006 on machines owned by the Department of Corrections (DOC), we obtained NetBIOS account information from four DOC machines. Two of those machines were identified as the primary domain controller (PDC) and the backup domain controller (BDC). Our scanning tools identified 6,976 user accounts on both the PDC and BDC. We noted the following issues concerning the identified user accounts.

- The default administrator account on both of these machines had not been renamed.
- The same 15 user accounts were noted on both machines with passwords aged greater than the maximum age allowed per the established password policy (31 days). The ages on these account passwords ranged from 33-41 days. One of these was the administrator account that had not been renamed as noted above.
- Information obtained concerning the users noted on the PDC revealed that 5,204 of the accounts established on that machine, or approximately 75%, had never been used to log onto the system. Eight of these users are included in the 15 accounts noted above concerning the password ages.

For security purposes, detailed information concerning the specific machines or user accounts that contributed to these findings is being intentionally omitted from this comment. However, these issues were thoroughly documented and communicated to the appropriate agency personnel.

Since the default administrator account cannot be locked out, if the account is not renamed it is more easily identifiable and that increases the likelihood the account could become vulnerable to guessed password attempts or brute force password attacks. Further, if the agency's established password policy is not properly enforced, it increases the likelihood that non-compliant user accounts could be compromised, as well as the underlying data accessible by those user accounts.

Default administrator, guest, and anonymous accounts in operating system and applications are some of the first accounts that an intruder will attempt to use. Therefore, they should be assigned strong passwords or, if possible, renamed or removed immediately after installation. Further, intruders often use inactive accounts to break into a network. If an account has not been used for a reasonable period of time, the account

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-DOC3-10: The Department of Corrections Should Strengthen The Security Of System Accounts (Continued)**

---

should be disabled until it is needed. This minimizes the possibility that an unauthorized user will access the account. Finally, security policies should be consistently applied.

**Recommendation**

We recommend that DOC ensure the following actions are taken on machines housing DOC resources:

- The identified default administrator accounts should be renamed to something more ambiguous in order to prevent unauthorized access.
- All user accounts on these network machines should be reviewed to determine whether the accounts to determine if they are still valid accounts that are required for a business-related purpose. If not, the accounts should be disabled or deleted depending on the necessity of reinstatement of the account. All accounts should be required to comply with established password policies on a consistent basis.

**Management's Response and Corrective Action Plan**

*Action Plan:*

*DOC Administration concerning administrator accounts - COT Active Directory Issue concerning our Organizational Units (OUs). We will discuss this issue with COT on this issue, as we get further into Active Directory migration. Review with COT all DOC network accounts to ensure they are valid accounts.*

*NOTE: Two machines do not reside or belong to DOC; they are owned, housed, and maintained by and within the COT Organization. Any changes required to these must be evaluated and implemented at the discretion of COT. Responsible Parties: Active Directory Team Anticipated Correction Date: 5/1/06 with reviews of network every 90 days.*

*COT Response:*

*The built-in administrator account has been renamed. Regarding the other user IDs, COT manages the domain controller but not the user environment. User creation and management is delegated down to the agency. It should be noted, however, that DOC is currently working with consultants in the early stages of migrating to Active Directory and may have many yet-unused accounts in their domain created for testing and preparation needs. Also, some of these accounts also are probably for email usage only, and therefore would show as having never been logged on from the perspective of most standard auditing techniques.*



**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-DWI1-11: The Department For Workforce Investment Should Implement Controls Over Systematic Programs To Ensure Accurate Information Is Available For Closing Package Reporting**

---

State Agency: Department for Workforce Investment

In reporting the delinquent employer contribution receivables on the closing package, several problem areas were noted again this year.

- Reports and/or payments were posted to an incorrect account and were not corrected during internal audit.
- Overpayments established over five (5) years ago were still on the system and reported as deferred revenue; information supporting the balance on these accounts had been purged and could not be verified.
- Two (2) reports/payments were not transferred correctly to the successor account, leaving a payable in the successor account and a receivable in the predecessor account or vice-versa.
- Three (3) balances could not be verified due to the age of the account or lack of documentation. Some balance discrepancies were discovered during testing; the agency lacked adequate supporting documentation to explain these differences.
- One (1) balance could not be confirmed.

The computer system used to generate the aging report for FY 06 produced unreliable, unformatted information for internal audit on DWI's Accounts Receivables.

In addition, DWI did not investigate and resolve in a timely manner potential benefit overpayments identified and had not established adequate internal controls over certain employer contribution refund checks or an adequate contingency recovery plan for its information systems.

In addition, there are no formal procedures or manual on processing accounts receivables in the computer system for possible trainees, DWI employees, or an auditor to comprehend within the audits.

Incorrect account balances result in an understatement or overstatement of receivables from delinquent employer contributions and deferred revenue on the closing package forms submitted to Finance and Administration Cabinet (FAC) for financial reporting purposes.

Proper internal control dictates the agency should have a computer system in place to adequately maintain employer accounts to ensure information input into the system is accurate and reliable.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-DWI1-11: The Department For Workforce Investment Should Implement Controls Over Systematic Programs To Ensure Accurate Information Is Available For Closing Package Reporting (Continued)**

---

Generally accepted accounting principles dictates that government funds recognize revenues in the accounting period in which they become susceptible to accrual - both measurable and available. Therefore, amounts that are available, but not otherwise measurable, should be reported as deferred revenues rather than as revenue.

**Recommendation**

During testing this year, we noted small areas of improvement from the prior year audit. However, there are several areas that still need to be addressed. Computer system and staff controls should be enhanced to ensure proper reporting of the closing package forms for financial statement purposes. Controls should be enhanced to prevent the reoccurrence of errors that affect the employer accounts. We recommend DWI regularly reconcile the accounts receivable recorded for benefit overpayments and amounts due from reimbursable employers in the system. We also recommend that the director and assistant director of Unemployment Insurance in the DWI continue to improve efforts in fiscal procedures in preparing accurate, reliable, and complete information on federal financial reports, in order to monitor and analyze data verification. The assistant director has commented that DWI would be creating monthly reports to resolve some of these issues in the future.

**Management's Response and Corrective Action Plan**

*We accept the auditor's findings that errors were identified during the period of auditor review. The majority of these errors were the result of a backlog of work due of lack of staff. Due to staff shortage, the auditors were reviewing data prior to final verification. We have recently increased staff in the tax accounting area and are reducing the backlog. The computer system is adequate to provide all of the support that tax accounting requires.*

*We do not accept the finding that the computer system we used to generate the aging report for FY06 was unreliable and that it did not provide properly formatted information. It was our understanding that the State Auditor's office was to request the accounts receivable report to be run on June 30<sup>th</sup> 2006. Due to miscommunication or misunderstanding the correct report was not run at that time and the error was not recognized for several weeks. The State Auditor's Office subsequently requested this report in late fall but, as the APA is aware, this report cannot produce accurate data if run after the fact.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-DWI1-11: The Department For Workforce Investment Should Implement Controls Over Systematic Programs To Ensure Accurate Information Is Available For Closing Package Reporting (Continued)**

---

**Management's Response and Corrective Action Plan (Continued)**

*Regarding the following recommendation found in the APA report:*

*"We recommend DWI regularly reconcile the accounts receivable recorded for benefit overpayments and amounts due from reimbursable employers in the system."*

*Since we do perform reconciliations, we need further clarification as to the recommended action before we can respond to these issues.*

*We accept the recommendation to improve the efforts and fiscal procedures in the preparation of federal financial reports and have requested the previously agreed upon programming to accomplish this.*

*We disagree with the weakness noted relating to lack of documented procedures and manuals. Policy and procedure manuals are available upon request.*

*We do not accept the weakness regarding internal controls over employer refund checks. Currently, two levels of supervision above the staff responsible for processing refund checks verify and approve each employer refund request. We file and retain copies of all documents.*

*Finally, the recovery plan for information system is the responsibility of DTS (Division of Technical Services) and COT. We are unable to respond to this issue.*

**Auditor's Reply**

We acknowledge the effort and comprehensive response to the findings above provided by the managers and staff at DWI. Clarification and response is provided below:

- Aging Report: We did not intend to state the computer system is unreliable, but the aging report provided by DWI in text file was not usable for analytics as we were not able to separate the individual columns. We recommend the aging reports run at June 30<sup>th</sup> be made in importable format file for analytic purposes, beneficial for DWI and APA. Next year's auditor will promptly import the report, any errors or difficulties will be brought to DWI's attention.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-DWI1-11: The Department For Workforce Investment Should Implement Controls Over Systematic Programs To Ensure Accurate Information Is Available For Closing Package Reporting (Continued)**

---

**Auditor's Reply (Continued)**

- Reconciliations: Differences between accounts receivables recorded for benefit overpayment and amounts due from reimbursable employers were found during our test. The reports run after June 30, 2006 could be part of the reason for the unresolved differences. However, DWI's internal audit division noted incorrect transfers discovered and corrections made to accounts receivable during their work. Therefore, we cannot be sure all the differences relate to timing. Although, reconciliations are done quarterly, we recommend a weekly or monthly basis, depending on the quantity of transactions, transfers and corrections, for accounts receivable accounts to be reconciled instead of waiting until the end of the fiscal year.
- Procedures and Manual: We will provide a written request for procedures and manuals on the operating the accounts receivable system program for the next fiscal year audit.
- Refund Check Internal Controls: We intended to state that internal controls over monitoring and review are insufficient to establish risk of invalid transactions or accounts prior to federal and state financial reports. Specifically, we looked at the employer accounts receivables accounts, not the refunded checks to employers.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-DWI2-12: The Department For Workforce Investment Should Strengthen Controls To Ensure The Accuracy Of Estimates In The Closing Package**

State Agency: Department for Workforce Investment

During testing of the FY 06 closing package, the R731 Allowance for Uncollectible amount was calculated by taking an average of the past two (2) years' write-off amounts; however, we verbally recommended a 3-year average in FY 06 and DWI agreed. It was determined the allowance was the 2004 and 2005 write-offs divided by two (2). The agency was unable to follow the auditor's calculation on the allowance estimate or methodology for determining this allowance.

The condition reported above was caused by lack of documented procedure. As a result of these findings, uncollectible allowance was overstated by \$420,329. This gives an inaccurate projection as to the amount the agency will be able to collect therefore, overstating receivables.

Sound accounting practice dictates entities re-estimate their allowance for uncollectible amounts each annual financial reporting date and when information indicates the latest estimate is no longer reasonable. Losses due to uncollectible amounts should be measured through a systematic methodology, remaining consistent from year to year. Furthermore, good internal controls dictate that adequate review procedures should be in place to ensure the closing package contains verifiable and accurate data before submission so amounts appearing on financial statements are reported accurately.

**Recommendation**

We recommend DWI implement controls to ensure closing package numbers are reported accurately. Closing package numbers should be properly documented and verifiable. The agency should document the method used in determining estimates so this can be done in a consistent manner each year. Agency should develop procedures to determine estimates and document them to ensure consistency.

**Management's Response and Corrective Action Plan**

*We agree with the recommendations.*

*We previously agreed with the State Auditor's Office to use the recommended three-year moving average formula for estimating uncollectibles and it was our intention to use that method of calculation for FY06. Due to a miscommunication*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-DWI2-12: The Department For Workforce Investment Should Strengthen Controls To Ensure The Accuracy Of Estimates In The Closing Package (Continued)**

---

**Management's Response and Corrective Action Plan (Continued)**

*of information, an incorrect amount was reported in the closing package. This specific error has been corrected.*

*We are in the process of documenting the method we use to calculate the three-year moving average, both the annual numbers that should be used and the mathematical formula for calculating the average. This procedure will be included in the Collections Manual at the earliest possible time.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-DWI3-13: The Department For Workforce Investment Should Implement Controls To Ensure Inactive Accounts Are Written Off Timely For Closing Package Reporting Purposes**

---

State Agency: Department For Workforce Investment

During testing of delinquent employer tax accounts, the auditor noted that many of the accounts had been in the system and reported as an account receivable even though they had been inactive for a number of years, some dating back to 1936. Most of the time these employers had gone out of business and/or declared bankruptcy. Out of a total of \$38,206,369 accounts receivable (after adjustment), \$12,186,728 was found to be over five years old and should be declared uncollectible. Once declared uncollectible, the account could be written-off and no longer included in the accounts receivable balance for the purposes of financial reporting. However, writing off an account for reporting purposes does not mean collection activity on the account ceases.

According to agency personnel, it takes some time to go through each of these accounts and declare them uncollectible. They are aware of the problem and had planned to correct it when time permitted. Inactive accounts being included in the balance overstates accounts receivable and does not give an accurate view of the amount the agency expects to collect.

Sound accounting practice dictates receivables should be evaluated periodically to determine the probability of collection. Then, the uncollectible portion should be written off. KRS 341.300 (4) states:

An action for the recovery of contributions, interest or penalties under this section shall be barred and any lien therefore shall be cancelled and extinguished unless collected or suit for collection has been filed within five (5) years from the due date of such contributions, except in the case of the filing of a false or fraudulent report the contributions due shall not be barred and may at any time be collected by the methods set out in this chapter, including action in a court of competent jurisdiction.

**Recommendation**

Inactive/old accounts should be declared uncollectible and written-off in a timely manner for financial reporting purposes. These accounts should not be included in the closing package.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-DWI3-13: The Department For Workforce Investment Should Implement Controls To Ensure Inactive Accounts Are Written Off Timely For Closing Package Reporting Purposes (Continued)**

---

**Management's Response and Corrective Action Plan**

*We agree with this recommendation.*

*We have written a request to have the accounts receivable aging report include only those accounts that are no more than five years old.*



**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-DWI4-14: The Department For Workforce Investment Should Review Closing Package Information To Ensure Accuracy**

---

State Agency: Department For Workforce Investment

For FY06, DWI prepared closing package forms and submitted them to FAC without adequate review. As a result, the issues below were noted.

- Employer Tax Contribution receivables estimate was erroneously calculated, understating the balance by \$7,333,822. An adjustment to FAC was recommended to correct this error.
- Incorrect figures were used to calculate Employer Tax Receivables, understating the balance by \$12,186,729. An adjustment to FAC was recommended to correct this error.
- Uncollectible Reports estimate calculation based on three (3) year average write-off was recommended and agreed to by management in 2005, but was not used for 2006. The allowance for uncollectible was overstated by \$420,329 and has been corrected.
- Several other mathematical errors were brought to the agency's attention during the course of the audit, most of which were corrected via amended closing package forms.

Similar problems were noted in the prior years.

The numerous errors noted in the closing package forms created erroneous financial statement amounts and required several revisions on behalf of the agency.

Good internal controls dictate that adequate review procedures should be in place to ensure the closing package contains verifiable and accurate data before submission.

**Recommendation**

We recommend DWI implement controls to ensure the closing package forms are prepared consistently and accurately before submission. Proper review of the closing package could prevent future errors. We also recommend the information reported on the closing package be properly supported and verifiable.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-DWI4-14: The Department For Workforce Investment Should Review Closing Package Information To Ensure Accuracy (Continued)**

---

**Management's Response and Corrective Action Plan**

*We agree with the recommendation of the APA that we must exercise proper review and oversight in the completion of the closing package. The first bulleted item (above) resulted from an error in a spreadsheet formula. The formula has been corrected. Henceforth, we will validate this formula prior to running calculations against it. We addressed the errors cited in the second and third bulleted items in our responses to 06-DWI3-12 and 06-DWI2-13, respectively. We corrected all of the above-mentioned errors and the errors cited in the fourth bulleted item in a corrected closing package, which we filed on 11-27-06.*

*Since several branches must supply information used in compiling the closing package, the Trust Fund Coordinator will circulate the completed package to appropriate managers for their review and verification of the data prior to submitting it to the APA.*

*In order to assure that the APA has the correct information it needs to review the program, departmental personnel will review all data requested by the APA prior to providing it to that office.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

**FINDING 06-EDU1-15: The Kentucky Department Of Education Office Of District Support Services Should Update And Consistently Apply Its Change Management Process**

---

State Agency: Department of Education

During the FY 2006 audit of the Kentucky Department of Education (KDE) system controls, it was discovered that the Office of District Support Services (ODSS) has a general program change control review and approval process in place; however, KDE had not formalized this process in standards or procedure statements specific to the agency. Further, the current process is not sufficient or adequately designed to ensure that only authorized changes to key applications are made.

Specific to the SEEK calculation program, the current KDE programmer makes changes to the code and places comments within the program code identifying the change made. Prior to implementation, two members of the ODSS supervisory staff review the proposed code changes and manually calculate the anticipated output figures to be produced by the programmer. Once changes are approved, the programmer then moves the executable files into production and executes the code. However, this process was not formalized or sufficiently documented. No program change forms were developed and the process of requests, reviews, and approvals for program changes were not adequately documented. Further, no log of requests or changes was currently maintained by the ODSS staff or programmer to monitor program change requests.

We have issued a separate comment, 06-EDU3-17, concerning the issue of the KDE programmer's excessive access to the production library.

Without a formalized program change control process and monitoring of the compliance with the process, the agency is at risk that procedures that are deemed vital to the process will be overlooked. For example, disregarding the procedure established to review supporting documentation for evidence that a change has been tested and approved for promotion to production increases the likelihood that unauthorized or inappropriate program changes could be placed in production.

A strong program change control process will ensure policies and procedures are formalized, distributed, and understood by all applicable agency personnel. This process should be consistently applied to all code changes to existing programs and the development of new programs.

All program modifications are to be monitored and thoroughly documented, with procedures established to log all program change requests, review and approval processes to be followed, and supporting documentation to be maintained for the process.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-EDU1-15: The Kentucky Department Of Education Office Of District Support Services Should Update And Consistently Apply Its Change Management Process (Continued)**

---

**Recommendation**

We recommend that ODSS formalize, implement, and consistently apply adequate program change controls. Specifically, the agency should, at a minimum:

- Develop a formal procedure for the program change control process. This formalized document should include the procedures to adequately identify program specifications and program objectives, to specifically identify changes in code by developing a code comparison listing between the original code and the revised code, to adequately test proposed program code changes, and to verify that all approvals are in place for the program code change before implementation to the production environment. If emergency situations are anticipated that might require this process to be accelerated, then that should be taken into consideration and an alternative process developed that properly applies compensating controls over that accelerated process.
- Develop a change request form that indicates what changes are to be made and what files/programs are involved, who is requesting the change, testing of the change, and authorization that the change was approved. This process should be included in the overall formalized procedure to ensure all employees involved with the process understand how to properly complete the form.
- Process all new programs or modifications to existing programs through the established program change control process as documented in the formal procedure.
- Ensure all changes comply with established program change control procedural requirements. Requirements should include procedures to ensure that an individual other than the programmer properly reviews and tests all changes for accuracy and that proper approvals are documented authorizing implementation of the change into production before the librarian moves the change to the production environment. After implementation of changes, the librarian should sign and date the change request form to affirm that this process has been completed.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-EDU1-15: The Kentucky Department Of Education Office Of District Support Services Should Update And Consistently Apply Its Change Management Process (Continued)**

---

**Recommendation (Continued)**

- Establish a logging feature within the program change control process. This log should include the name of the originator, origination date, brief description of problem, programs affected, completion date, and implementation date.
- Establish a centralized location for maintaining all complete change request forms.

**Management's Response and Corrective Action Plan**

*In response to the recommendation that the Office of District Support Services formalize, implement and consistently apply adequate program change controls, the following corrective actions are planned:*

- 1. ODSS will develop a formal procedure for the program change control process. In February 2006, ODSS hired an individual to serve as Technology Project Manager who has the responsibility to develop the change control process. The procedures will be documented and implemented as a standard operation. The procedures will include program identification, requirement specifications, test plans, and management approval. ODSS has also implemented Visual SourceSafe as the code repository (provides version control and code comparison functionality). The procedure will also document an alternative for emergency situations when the standard process must be expedited. The change control process will be documented and functional by August 1, 2006.*
- 2. ODSS has instituted a project request form that encompasses the recommendations for a change request form.*
- 3. The procedures will apply to new application development as well as modification of existing programs.*
- 4. The Technology Project Manager will monitor compliance with the change control procedural requirements. This includes the validation of user testing and authorization to implement the change into production. ODSS has designated a librarian to move the change to the production environment and add the completion to the change request form.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-EDU1-15: The Kentucky Department Of Education Office Of District Support Services Should Update And Consistently Apply Its Change Management Process (Continued)**

---

**Management's Response and Corrective Action Plan (Continued)**

5. *The Technology Project Manager will maintain a portfolio of all maintenance and new development requests as the recommended logging feature.*
6. *All change requests and supporting documentation will be maintained in the ODSS Projects folder on the server.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-EDU2-16: The Kentucky Department Of Educations Office Of District Support Services Should Formalize And Consistently Apply Its Logical Security Policies**

---

State Agency: Department of Education

During the FY 2006 audit of controls for the KDE, it was determined that the ODSS did not properly secure the critical financial data associated with the SEEK program. Also, ODSS had not developed or implemented a formalized security policy that identifies management and user responsibilities concerning IT security surrounding the SEEK program and other applications developed and maintained by ODSS. Our audit identified multiple security issues concerning logical security of ODSS related servers as explained below.

The audit revealed that critical SEEK executable programs were placed on a KDE server that was not adequately secured. The Office of Education Technology (OET) server on which the SEEK production executables were placed was a server intended only for temporary storage of general information and it was accessible by all KDE employees and contractors during the audit period to date. The executable programs were originally moved to OET by a SEEK programmer from an ODSS file server without the knowledge of OET. We have reported on the control weakness concerning programmer access to the SEEK production executables in a separate comment, 06-EDU3-17, as a segregation of duties weakness. Upon auditors notifying ODSS that program executables were accessible to all KDE employees, the folder on the OET server where the SEEK executables resided was restricted to certain ODSS employees. However, the SEEK programmer in question is still one of the users that retains access to those executable programs. Further, we noted that the original ODSS server location from where the SEEK executables were moved was not adequately secure, as all ODSS employees had access to that SEEK directory. That access was not necessary for the performance of their job duties.

In addition, we noted various security issues concerning user accounts accessing ODSS servers. One user account was being shared by four separate users on one of the two structured query language (SQL) ODSS servers where the SEEK code had previously been housed. That same user ID and the associated password was also hard coded into the program code designed to retrieve information from other programs to be utilized in the SEEK calculation. It should be noted that a copy of these scripts were stored on the unsecured OET server with the executables discussed above and were also accessible by all KDE employees and contractors until our field work identified the issue. We also noted two unnecessary system accounts and three unnecessary individual user accounts on this SQL server, two of which belonged to users who initially worked for ODSS, but

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-EDU2-16: The Kentucky Department Of Education Office Of District Support Services Should Formalize And Consistently Apply Its Logical Security Policies (Continued)**

---

no longer works in ODSS and one of which works in OET but does not require this access. This access has been subsequently removed.

We tested to ensure that confidentiality forms were on file for the 11 individual users with directory level and/or System Administrator access to the ODSS server. One of the forms was not available. Since ODSS is responsible for determining the access needed by ODSS employees to OET's file transfer protocol (FTP) server, we also tested to ensure that confidentiality forms were on file for the 10 ODSS individuals that were able to download district-level MUNIS reports from that server. Our testing revealed that confidentiality forms were not on file for two ODSS users with access to that FTP server. In addition, one other employee that was previously responsible for the distribution of MUNIS reports, but no longer works for ODSS, had an improperly authorized confidentiality form on file. Furthermore, two employees had access to this FTP server that was not required, given their job duties.

Due to security control weaknesses identified with the ODSS servers, we requested to review the server logs that would identify users that accessed the servers and specific programs during our audit period. However, KDE/OET did not have object access audit logging established on these servers so we could not identify nor determine the appropriateness of any user access to the servers during the audit period.

It was also noted that a Database Administrator (DBA) had not been appointed to oversee one of the two SQL servers where SEEK data is housed, nor for the ODSS file server on which the SEEK executables originally resided.

Without strong, formalized, logical security controls, the opportunity increases for unauthorized modification to production files as well as the likelihood of errors or losses occurring from incorrect use of data and other resources. The lack of formal security policies was key in allowing the various security weaknesses noted. The fact that the SEEK program was executed in an unsecured environment could affect the reliability of any resulting output from that system that might be used for management decision-making purposes or for the distribution of SEEK funds. Even though access has now been further restricted, the SEEK programmer still has access to the executables, and ODSS is not monitoring file access because the programs reside on a server for which OET is responsible. This gives evidence to the fact there is not a clear understanding between the various Business Units and OET as to who has the responsibility for maintaining adequate security over KDE IT resources, which we have addressed in a separate comment, 06-EDU4-18.



**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-EDU2-16: The Kentucky Department Of Education Office Of District Support Services Should Formalize And Consistently Apply Its Logical Security Policies (Continued)**

---

Formalized and consistently applied security policies set the tone of management concern for strong system security and provide a security framework used to educate management and users on their responsibilities. System security should be administered in such a way as to ensure proper segregation of duties. System access should be limited to the level necessary to perform assigned duties. Granting users system access that would allow the ability to alter or delete programs or financial data prior to or subsequent to processing increases the risk of financial misstatements or fraudulent reporting. The use of group accounts does not provide an adequate audit trail for transaction processing. Audit logging should be implemented to capture user access of critical programs and data. Default system or user accounts are some of the first accounts that a hacker would attack and should, therefore, be assigned strong passwords or, if possible, be renamed or removed immediately upon installation.

**Recommendation**

We recommend that ODSS formalize, implement and consistently apply a security policy that standardizes security responsibilities for all ODSS employees and ensures critical ODSS programs and data are properly secured. Specifically, the agency should, at a minimum:

- Ensure that the SEEK executables are returned to their original location on the ODSS server so that they are maintained and supervised by ODSS.
- Ensure that programmers, as well as any employees that do not specifically require access, are not allowed access to the executables in order to maintain proper segregation of duties.
- Ensure that any other SEEK program scripts or code that were placed on the OET file server are returned to the ODSS SQL servers.
- Object access audit logging should be established on all ODSS servers.
- User authentication should be used in any processes or code requiring authorization rather than maintaining hard coded usernames and passwords in the code. Hard coded usernames and passwords in program code should be eliminated.
- The practice of using shared user accounts should be terminated immediately.
- All individual user accounts should be analyzed to determine if they are necessary. If not, they should be removed. This process should be re-performed on a periodic basis.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-EDU2-16: The Kentucky Department Of Education Office Of District Support Services Should Formalize And Consistently Apply Its Logical Security Policies (Continued)**

---

**Recommendation (Continued)**

- Any default system accounts should be reviewed to determine their necessity. Unnecessary accounts should be disabled.
- A Database Administrator (DBA) should be appointed with oversight over the SQL server where the SEEK data resides, as well as the server on which the executables are placed. Accordingly, the DBA should be responsible to establish and monitor all current employee's access levels on an ongoing basis to ensure access levels facilitate a proper segregation of duties and do not allow inappropriate access to production data. This review should be thoroughly documented for audit purposes.
- Ensure that access to electronic resources is removed promptly upon termination of employment.
- Ensure that confidentiality forms are properly authorized and maintained on behalf of all ODSS employees.

**Management's Response and Corrective Action Plan**

1. *The Office of District Support Services is in the process of moving all files, databases, and programs to new servers. This migration is scheduled for completion by July 1, 2006, and KDECPFN1 and KDECPFN2 will no longer be used.*
2. *In order to preserve separation of duties, the servers KDEODSSOA1 and KDEODSSOS1 are managed by an ODSS Server Administrator and the MS SQL Server databases are managed by the ODSS DBA.*
3. *The Server Administrator will take the necessary steps to implement object access audit logging by July 1, 2006.*
4. *All ODSS files, databases, and programs will be on ODSS Servers by July 1, 2006.*
5. *ODSS will review all production applications for hard-coded user names and passwords. Any applications requiring modification to replace hard-coded user names and passwords will be handled through the change control process.*
6. *Shared User Accounts will be identified and eliminated by July 1, 2006.*
7. *The Server Administrator will provide ODSS management with a report of individual user accounts for verification by July 1 of each year. The SA will maintain documentation for all requests to add, change or delete a user account.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-EDU2-16: The Kentucky Department Of Education's Office Of District Support Services Should Formalize And Consistently Apply Its Logical Security Policies (Continued)**

---

**Management's Response and Corrective Action Plan (Continued)**

8. *The SA will provide a listing of default system accounts to the ODSS Leadership team by July 1 of each year.*
9. *ODSS has designated a DBA to monitor access to production level databases and facilitate the proper segregation of duties.*
10. *The ODSS leadership team will route EP-1 documents received from HR to the SA for appropriate action. For a terminated employee, the SA will disable access as quickly as possible and notify leadership upon completion.*
11. *The Division of Human Resources in OIAS is responsible for the maintenance of confidentiality forms on behalf of ODSS.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-EDU3-17: The Kentucky Department Of Education Office Of District Support Services Should Ensure Proper Segregation Of Duties**

---

State Agency: Department of Education

During the FY 2006 audit of the KDE system controls, it was determined the ODSS did not employ proper segregation of duties between the system programming and operation functions. Specifically, one KDE programmer was also functioning as the librarian and computer operator for the SEEK calculation program.

As a result, the programmer had the ability to make changes to the program code, move those changes to the production environment, and execute the code. The programmer also had a backup copy of the SEEK executables saved within his personal drive on the server. Although a current authorization process is in place for change controls, the process was not formalized and does not provide compensating controls concerning these incompatible duties performed by the programmer.

The lack of formalized policies and procedures governing the change control process at ODSS was addressed in a separate comment, 06-EDU1-15.

In addition, it was determined that the same programmer noted above moved the SEEK executables and other program code to an unsecured location on an OET server without the knowledge of OET. The security of the SEEK executables and program code was addressed in a separate comment, 06-EDU2-16, regarding logical security.

Employing strong segregation of duty controls decreases the opportunity for unauthorized modification to files and programs, and decreases the likelihood of errors or losses occurring because of incorrect or unauthorized use of data, programs, and other resources.

Computer programmers should not have direct access to the production version of program source code or be able to directly affect the production environment. The reason for this control is to ensure that the programmer does not intentionally or unintentionally introduce unauthorized or malicious source code into the production environment. Smaller organizations that cannot easily segregate programmer duties from computer operator duties should implement compensatory controls to supervise and monitor programmer activities to ensure only properly tested and authorized programs are migrated into production.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-EDU3-17: The Kentucky Department Of Education Office Of District Support Services Should Ensure Proper Segregation Of Duties (Continued)**

---

**Recommendation**

We recommend ODSS ensure that someone other than the programmer be required to move changes into the production environment and execute the program code. Consequently, it is unnecessary for the programmer to have access to the production executables, and the executables should not be maintained on the programmer's personal drive. All production programs and data should be secured separately from the change and testing environment in order to maintain proper segregation of duties. ODSS supervisory staff should continue to thoroughly review and document all program changes made by the programmer to ensure they are appropriate prior to processing.

**Management's Response and Corrective Action Plan**

*The Office of District Support Services will restrict developer's access to 'Read Only' in the production environment. ODSS will maintain separate environments for development, testing, and production. The segregation of duties will be documented in the change control process and monitored by the Technology Project Coordinator. ODSS will be fully operational with the change control process by August 1, 2006.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-EDU4-18: The Kentucky Department Of Education Should Implement A Comprehensive Information Technology Policy And Ensure Adequate Oversight Authority Is Established**

---

State Agency: Department of Education

During the audit of KDE system controls, we determined that a governance model or oversight authority was not adequately established to ensure adequate information technology (IT) control policies and procedures were implemented to secure IT resources of the various KDE Business Units.

A “Business Champion” concept was implemented within KDE so that critical projects or processes within KDE would be provided adequate leadership and oversight by management and other stakeholders that are involved with and operate the projects on a daily basis. The current KDE business approach involves various Business Units. This structure provides the Business Units with input into the IT infrastructure decisions involving its projects. Though OET provides certain operating services, the ownership of certain portions of the infrastructure lies with the Business Units. Having infrastructure that is not centrally maintained and is outside the core functions of the OET staff has created a situation where the responsibility for the development and implementation of formal IT control and security policies is unclear to both OET and the business units.

OET creates ‘guidelines’ and disseminates best practice information to assist KDE Business Unit personnel with the configuration and settings related to the IT network or the implementation of new technology products. However, the delineation between OET and the business units is unclear as to the authority and responsibility to ensure compliance with IT standards and policies. Because a decentralized structure has been created to provide business units with more control over sub-systems that require program input, KDE does not have a Centralized Security Officer (CSO).

Based on our testing and discussions, it is apparent that Business Unit leaders or champions are not fully aware of the need or responsibility to establish and implement IT controls. We tested IT controls within one Business Unit responsible for the operation of MUNIS and the SEEK systems. These were the primary systems included in the audit scope. Our testing revealed weaknesses with IT security controls for those systems. The IT security weaknesses identified with these two programs have been commented on separately (06-EDU2-16, 06-EDU3-17, 06-EDU5-19). Weaknesses noted included a lack of any basic formal IT security control policies within the audited Business Unit responsible for these systems. Testing within this area revealed that the Business Unit managers were not aware of the responsibility to develop and implement formal IT

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-EDU4-18: The Kentucky Department Of Education Should Implement A Comprehensive Information Technology Policy And Ensure Adequate Oversight Authority Is Established (Continued)**

---

control policies and procedures. When OET directed the auditors to the Business Unit management for answers to IT control questions related to those systems, the auditors were often redirected back to OET by the Business Unit with management's assumption that IT controls were OET's responsibility.

We did note during our testing that all employees of the Education Cabinet are required to sign an Acceptable Use Policy, which was established as a result of legislative regulations (701 KAR 5:120) to ensure employees did not use technical resources to access inappropriate material on the Internet. However, this was the only formalized IT policy identified during our fieldwork that required compliance by the Business Unit system operators or end users.

We also noted that KDE has created the Technology Planning Council (TPC) to ensure that technology-enabled business initiatives are successful. The TPC guides the deployment of IT resources to meet the priorities of KDE, the Kentucky Board of Education and the local school districts. Key management employees from OET are members of TPC. This approach by TPC and KDE appears to have assisted in providing Business Units more input into IT infrastructure decision making and the standards to be met for IT resource procurement and installation, but standardized IT control policies and procedures have not been developed or implemented.

Therefore, in summary, though we agree that Business Units should be involved in developing IT strategies and making other technology decisions, we believe a centralized IT governance authority is needed to ensure that standardized IT control policies and procedures are established and consistently implemented within KDE for all IT systems. This same conclusion concerning centralized IT control oversight had been provided to KDE within a report provided by Gartner, Inc (Gartner) in 2004 as a result of their IT assessment and optimization study. Discussions revealed that KDE had intended to comply with the Gartner recommendations but it appears the decisions for authorizations and responsibilities to establish and implement IT controls was not properly established or communicated to all parties.

Because of the organizational structure of KDE, Business Units do not report to OET and OET does not have primary responsibility for maintaining all IT systems. This situation resulted in inconsistent and incomplete controls over the KDE network and IT resources. Business Units were not required to establish and implement formal IT control policies and procedures.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-EDU4-18: The Kentucky Department Of Education Should Implement A Comprehensive Information Technology Policy And Ensure Adequate Oversight Authority Is Established (Continued)**

---

A comprehensive IT policy defines management and user responsibilities and obligations for the maintenance, security, legal and appropriate use of the KDE network and IT resources. Much of the information that KDE employees use or rely on is provided via the data network and the Internet itself. While these networks offer invaluable opportunities for sharing information and for working more efficiently, they also offer potential points of unauthorized access into KDE's data, e-mail accounts, and other valuable and often confidential information. IT control policies and procedures should be standardized, consistently applied, and monitored for compliance to ensure proper system and control development, implementation, and management.

**Recommendation**

We recommend that KDE establish an appropriate IT governance authority to design and implement standard IT controls and to provide centralized oversight of these controls for all KDE IT resources. We recommend that any authority that is established for this purpose have the necessary qualifications to ensure established IT control policies and procedures are adequately designed and implemented. We recommend that management of all Business Units and the applicable system users be properly advised of the responsibility to comply with established IT control policies and procedures.

Consideration of IT controls, at a minimum, should include acceptable use of network resources, physical and logical access security controls, program change controls, and business recovery.

**Management's Response and Corrective Action Plan**

*KDE acknowledges that additional IT controls and policies need to be formalized and implemented throughout all of the business units within KDE. Because this issue affects a number of different offices throughout KDE, the solutions will require significant planning and collaboration between OET and the other various business units. These issues will be addressed initially by the Technology Planning Council and consideration will be given to a centralized authority for oversight of IT controls and procedural implementation.*



**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-EDU4-18: The Kentucky Department Of Education Should Implement A Comprehensive Information Technology Policy And Ensure Adequate Oversight Authority Is Established (Continued)**

---

**Management's Response and Corrective Action Plan (Continued)**

*KDE will develop policies to address program change controls, logical security access controls and disaster recovery, as well as, any other IT security control weaknesses. These standards and procedures will then be communicated across all business units in KDE. We expect that a comprehensive plan, procedure development and implementation across all business units will take at least one year. KDE expects to implement the changes by July 1, 2007.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-EDU5-19: The Kentucky Department Of Education Office Of Education Technology Should Formalize And Consistently Apply Logical Security Policies For The KETS Network And MUNIS**

---

State Agency: Department of Education

During the audit at KDE, OET did not develop or implement a formalized security policy that identifies management and user responsibilities concerning security surrounding the Kentucky Education Technology System (KETS) network. Further, adequate controls were not established to properly secure the critical financial and personal data that is transferred from the 176 Kentucky school districts to OET's MUNIS gateway server.

As noted in a separate comment, 06-EDU4-18, KDE has established various Business Units that have been given the responsibility of maintaining adequate information technology controls for resources used to support its major programs. However, there remain various central workstations and servers, as well as related OET employee and contractor network access, for which OET management is responsible. Our audit revealed that OET had not implemented a formalized security policy to control system access by these employees and contractors, nor to control access to OET maintained servers by system users within other business units.

The school districts primarily use the MUNIS financial system to manage their finances. In addition, certain financial and staffing reports exist that KDE uses from the districts for state and federal purposes. When districts are ready to forward reports to KDE, the KYTRANSFER utility is used in order to place the reports in an outbox located on their MUNIS server located at the school district. From there, the KYCOLLECTION utility automatically collects and transports the reports to KDE's MUNIS gateway server that OET manages. These reports are then moved to the FTP server for pickup by ODSS staff.

During the course of our fieldwork, we identified seven (7) OET employees with access to the MUNIS Gateway server through group account, individual user account, or both. We examined the confidentiality statements for all seven users to ensure this access was properly authorized. Our examination revealed that three of the users accessing this server were contractors and had this access since as early as the year 2000. However, the KDE supervisor for these three contractors did not provide documented authorization for this access until February 2006.

Our testing also identified eight group accounts that were established for accessing the MUNIS gateway server in order for OET to provide technical support to the school

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-EDU5-19: The Kentucky Department Of Education Office Of Education Technology Should Formalize And Consistently Apply Logical Security Policies For The KETS Network And MUNIS (Continued)**

---

districts. These group accounts are also used when accessing a school district's server. Review of these accounts indicated that one group account established on the MUNIS gateway server was unnecessary in relation to the function of the server.

However, group accounts with a shared password should never be employed, especially for users with system access greater than READ capabilities, as they provide an inadequate audit trail of the actual user's identity.

Discussions did reveal that although KDE/OET had not implemented a formal security policy, an informal policy was in place requiring OET/KDE staff to first obtain authorization from the school district before accessing that district's MUNIS server or software. However, logs are not maintained that track access to district servers. We also noted that OET does not generally have Object Access audit logging implemented on its critical servers.

Our testing also revealed that many of the MUNIS reports submitted to KDE contain confidential information that is not encrypted during transmission. Though this information does remain within the KDE network and is not accessible from external machines, we still consider this a security concern. Based on our discussions with district personnel, this issue has also been a concern expressed by districts in the past. Discussions revealed that OET does plan to use secure tunnels (IPSec) in the future to protect the data that is transferred from the districts. This security feature was not available until the 2004 version of MUNIS and not all school districts had been upgraded to this version at the time of our fieldwork. Once all districts have upgraded to MUNIS 2004, OET plans to ensure IPSec is implemented.

Our testing also revealed that all KDE users were granted Local Administrator rights on their workstations. This is considered unnecessary access for all KDE employees to have. Technical and support staff should be the only personnel with this level of access to prevent the accidental or intentional introduction of viruses or the loss of programs or data and to ensure workstations utilize only approved software.

Without strong, formalized, logical security controls, the opportunity increases for unauthorized modification to financial and staffing reports as well as the likelihood of errors or losses occurring from incorrect use of data and other resources. Failure to properly encrypt confidential information during transfer within the KETS network exposes KDE/OET to unnecessary liability that could result from a failure to adequately secure such data should that data be captured and used inappropriately. Granting users

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-EDU5-19: The Kentucky Department Of Education Office Of Education Technology Should Formalize And Consistently Apply Logical Security Policies For The KETS Network And MUNIS (Continued)**

---

local administrator rights to their workstations allows those users the ability to download and install unauthorized software as well as possibly pirated data.

Formalized security policies set the tone of management concern for strong system security and provide a security framework used to educate management and users of their responsibilities. System security should be administered in such a way as to ensure proper segregation of duties. System access should be limited to the level necessary for performing assigned duties. Granting users system access that would allow the ability to alter or delete programs or financial data prior to or subsequent to processing increases the risk of financial misstatements or fraudulent reporting.

Confidential data that is transmitted over networks should be properly secured by strong encryption or other similar measures. Further, access to servers that house critical financial and staffing data should be restricted to only necessary employees. Intruders often use inactive accounts to break into a network. If an account was not used for a reasonable period of time, the account should be disabled until it is needed. This minimizes the possibility that an unauthorized user will access the account. Finally, system user accounts and audit trails should be established in a manner to enable proper identification and tracking of user activity.

**Recommendation**

We recommend that OET develop and implement a formalized security policy that standardizes security responsibilities for all OET employees and ensures critical programs and data, as well as the servers housing such data, are properly secured. Also, OET should ensure that when all school districts upgrade to the most current version of MUNIS that IPSec Tunnels be implemented and used to secure the data being transmitted. This should be made a priority by the agency. Object Access audit logging should be enabled on all OET servers so that inappropriate use of resources can be further investigated, if the need arises. A security log should be established for all KDE employees to use that must access a school district's MUNIS server. OET should review the user and group accounts that are currently being used to ensure there is a legitimate business necessity for having them. If it is determined they are not necessary, they should be disabled.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-EDU5-19: The Kentucky Department Of Education Office Of Education Technology Should Formalize And Consistently Apply Logical Security Policies For The KETS Network And MUNIS (Continued)**

---

**Management's Response and Corrective Action Plan**

*OET agrees with all recommendations and will implement a formal policy and controls to standardize security responsibilities for all OET employees that ensure critical programs, data and associated hardware are properly secured. Completion date is February 1, 2007.*

*OET has just completed the upgrade of all districts to the most current version of MUNIS. OET has also initialized a project to move all districts to a secure data transfer mode before Jan 1, 2007. The project is well into the design and vendor engagement steps.*

*OET will enable the audit logging function on all OET agency servers by August 30, 2006. After implementation OET will monitor the performance cost on each server and provide options to overcome any identified performance deficits. For the servers physically located in each school district, that provide shared services such as Active Directory and Exchange, OET will engage Microsoft to assist in analyzing this change to a productive environment before January 30, 2007. The extent of this project will depend on the analysis and recommended approach.*

*OET will initiate a process development discussion with other KDE Agency Offices, which require access to school district MUNIS servers, to establish an overall security access policy and access log strategy. The completion date for the discussion and analysis is August 30, 2006. Completion goal for implementation is January 30, 2007.*

*OET will immediately engage the KDE MUNIS business owners to review user and group accounts that are currently being used to ensure there is a legitimate business need for each. Alternative methods for secure access will also be discussed and evaluated. Any accounts that are not necessary will be immediately disabled. Review and completion of this is before October 30, 2006.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-EDU6-20: The Kentucky Department Of Education Should Formalize The Task Order Process And Ensure Business Units Review Contractor Performance**

---

State Agency: Department of Education

During the audit KDE, we determined that KDE did not provide adequate oversight of the contracting and procurement process associated with critical IT personnel services within the agency. Further, OET did not formalize procedures involving contractor oversight and the procurement process to assure that Task Orders, contractor invoices, and contractor timesheets are complete, reviewed, and approved.

The Office of Internal Administration and Support (OIAS) performs the process of establishing a contract for services or commodities used within KDE. Each Business Unit requiring contracted services or commodities assists OIAS in this process. OIAS staff stated that once a contract is in place, the Business Owner is ultimately responsible to monitor the contract. KDE provided a listing of 36 contracts managed by OET and used to procure technology-related products and services using KETS funds. Our testing revealed that while a Business Owner was not formally assigned to any of these contracts, an Executive Sponsor and Product Manager were assigned. According to OET, Business Owner and Product Manager are interchangeable terms.

OIAS does have a Management Advisory Procedures (MAP) Manual that defines contracting terms and provides guidance concerning some contractual issues; however, the job function and responsibilities associated with a Business Owner, Executive Sponsor, or Product Manager have not been formally documented within this manual. It was also noted that the TPC, which was created to ensure that technology-enabled business initiatives are successful, has defined the roles associated with an Executive Sponsor and Product Manager; however, the responsibilities associated with contract oversight have not been defined. As a result, the procurement process may suffer without a clear understanding of the roles and associated responsibilities.

In addition, KDE uses the Systems Development Services (SDS) contract to obtain IT-related contractors from various vendors. The SDS contract is procured through the Commonwealth Office of Technology (COT) and is an avenue for all Executive agencies to obtain project managers, programmers, consultants, and database analysts without having to go through an RFP process. The SDS contract allows KDE to attract highly skilled technical staff that it otherwise would not be able to hire and retain. Funding to support the payments for contractor labor is formally requested through a Task Order that is first approved by OIAS and then gets final approval from the Finance and Administration Cabinet. Only two employees within OIAS can approve Task Orders and

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-EDU6-20: The Kentucky Department Of Education Should Formalize The Task Order Process And Ensure Business Units Review Contractor Performance (Continued)**

---

other agreements on behalf of KDE. However, approval from the requesting Business Unit is not required on the Task Orders prior to OIAS providing approval.

Our audit revealed there is generally a lack of documentation concerning KDE management oversight of contractors involved with system related duties working within OET or other Business Units. Discussions with the agency revealed that OET is involved in the contract personnel hiring process in that they have the ability to interview and select the contractor that is hired from a vendor, as well as request replacements if necessary. Contractors working within OET are assigned to specific service teams, which report to one of two agency Directors. It was noted that some of the service teams are lead by other contractors. This organizational structure of contractors reporting to other contractors may not allow OET to adequately monitor the work performed by a contractor. Discussions revealed that the Directors do meet with contract staff periodically to ensure the goals of OET are achieved. However, minutes from these meetings are not formally documented. The two Directors within OET review and approve vendor-supplied invoices for contract labor on a monthly basis. In addition, the vendor provides OET with weekly timesheets for each contract employee. OET maintains a spreadsheet to track the total hours worked by each contractor by month and year-to-date, as well as the cost associated with these hours. However, documentation obtained during the course of our fieldwork did not provide any indication that OET management approves the weekly timesheets for contractors. Further, our testing indicated that various contractors have access to the OET maintained spreadsheets as a result of their assigned job duties.

Without formalized and consistent procurement and contract monitoring procedures, KDE may not be obtaining adequate value for the contract services being provided. In addition, work productivity may suffer without clearly defined contract labor performance measures to ensure they are complying with standards set forth in the formal Task Order. Furthermore, the opportunity exists for contractor labor to alter the total number of hours they worked and may not actually be working the hours formally requested.

A formalized contract administration program is essential to assuring adequate contractor performance. Also, clearly defined contract management practices will ensure the state receives goods and services in a timely fashion and within budgeted constraints.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-EDU6-20: The Kentucky Department Of Education Should Formalize The Task Order Process And Ensure Business Units Review Contractor Performance (Continued)**

---

**Recommendation**

We recommend that KDE develop and formalize a contract management policy that addresses the Task Order process including compilation, review and approval. Each Business Unit should ensure that a Business Owner is formally assigned to a contract. OIAS and OET should work in conjunction to ensure adequate oversight has been delegated for all KETS system related contracts.

Also, each Business Unit requiring contractor labor should formalize procedures to monitor hours worked and performance measurement. Meetings held with service teams and contractor labor should be formally documented to ensure KDE can provide proper feedback to the vendor concerning work performed. Documentation used to monitor hours worked should be properly secured in a location that prevents unauthorized contractor access. In addition, guidelines for procedures to review and monitor contractor performance should be added to the annual Task Order and MAP manual to ensure contracted employees meet the standards established within the Task Order. OIAS should also update the Task Order Agreement form to allow the Business Units to provide documented initial approval.

**Management's Response and Corrective Action Plan**

*KDE is in full agreement with the recommendations contained herein. In response to this recommendation, KDE will, within 90 days:*

- 1. Update the Management Advisory Procedures (MAP) Manual to include job function and responsibilities associated with a Business Owner, Executive Sponsor, or Project Manager.*
- 2. Via the Technology Planning Council (TPC), outline and document the responsibilities associated with contract oversight and formalize a contract management policy.*
- 3. Require signature approval from the Business Unit on all Task Orders prior to OIAS approval.*



**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-EDU6-20: The Kentucky Department Of Education Should Formalize  
The Task Order Process And Ensure Business Units Review Contractor  
Performance (Continued)**

---

**Management's Response and Corrective Action Plan (Continued)**

4. *Prepare appropriate documentation to define and guarantee management oversight for contractor services involved with system-related duties working within KDE.*
  - *Require all contractors be monitored by the Project Manager for hours worked and tasks performed.*
  - *Require documentation of meetings between directors/managers of KDE who meet with contract staff to ensure that goals/initiatives of KDE are achieved.*
  - *Require that KDE management approve and retain the weekly timesheets of contractors. Establish a retention schedule to support such.*
  - *Evaluate contractor access to KDE financial and procurement systems to ensure there is no unauthorized access. Eliminate any identified access.*
5. *Create and enforce a contractor evaluation system.*
6. *Conduct periodic audits of the process. Correct and improve process, as needed.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-FAC1-21: The Finance And Administration Cabinet Should Ensure Contracts Are Being Monitored For Vendor Compliance As Specified In The Contract**

---

State Agency: Finance and Administration Cabinet

The auditor tested contract C-04566296 for compliance with the Finance and Administration Cabinet's (FAC) policies and procedures relating to the procurement process and for after award compliance with the contract requirements. The contract was entered into on September 28, 2005 with a contract effective date of October 1, 2005. The contract is between FAC on behalf of all agencies in the Executive Branch of State Government and Pepsi Cola North America and the following Pepsi Cola Bottlers: G & J Pepsi Cola Bottlers, Pepsi Americas, Pepsi Cola Mid-Americas (Marion, IL), Pepsi Cola Bottling Company (Corbin) and Bottling Group, LLC (doing business as the Pepsi Bottling Group). Pepsi Americas was appointed as the Contract Administration for this contract and were to handle any administration issues that cannot be resolved with the above parties.

Section 30.045 - Adding Facilities Agencies and Locations reads in part "...All agencies of Executive Branch of State Government shall purchase their Product (Pepsi) requirements from one or more of the Vendors, and that participating agencies shall not purchase, sell, advertise, dispense, or otherwise make available Product competitive with the Vendors Product". The exceptions to this requirement are The Office of the Blind and some of the Adult Correctional Facilities.

During this testing, we noted the following non-compliances:

1. No documentation indicating that the marketing requirements as stated in Section 30.030 of the contract were being followed and properly implemented.
2. Based on discussions with agency personnel, no verification or documentation was provided for In-Kind Services as required in the contract under section 30.040. The costs to the Commonwealth are stated as no less than \$725,000 per year.
3. None of the required reports were obtained for this contract as required under section 30.140 of the contract.

FAC relied on other participating agencies that are using this contract to ensure that the vendor's marketing requirements, In-Kind Services requirements, and vendor reports requirements were being met. There does not appear to be after award monitoring by either FAC or the participating agencies to ensure the vendor provided the Commonwealth with the services stipulated by the contract.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-FAC1-21: The Finance And Administration Cabinet Should Ensure Contracts Are Being Monitored For Vendor Compliance As Specified In The Contract (Continued)**

---

The effect of an agency not monitoring the contract is:

- The marketing monies invested by the Commonwealth of \$40,000 per year cannot be verified as being used to promote the Kentucky Unbridled Spirit brand as required by the vendor in the contract.
- The In-Kind Services monies invested by the Commonwealth of no less than \$725,000 per year cannot be verified as being used to promote the Kentucky Unbridled Spirit brand as required by vendor in the contract.
- The required reports indicated in the contract to be “one of the most important tools to monitor the contract’s size and usage”, were not obtained and therefore the Commonwealth was not given clear representation of the vendor’s performance.

Section 30.030 of the Contract states:

Vendors shall invest monies annually in a marketing program with the Commonwealth of Kentucky. Each Vendor will have staff dedicated to working with the Commonwealth to promote the Vendor’s Product and the Kentucky Unbridled Spirit Brand.

All marketing programs will be designed, implemented and mutually decided upon to create an increased demand for the Product and to extend the branding message of the state.

For these considerations, each Vendor will be allowed to refer to itself in all marketing, public relations, and sales efforts during the life of the contract, as the Contract Holder for Soft Drinks of the Executive Branch of State Government”.

The Commerce Cabinet agrees to provide the vendors (collectively) with \$40,000 worth of lodging at various state resort parks based on availability at any time during the year. Each drive away lodging package includes a three (3) day, two (2) night stay. Additional drive away lodging packages can be purchased at the published Commonwealth employee rate at the time of purchase.

Section 30.040 of the contract states:

Together the Vendors shall provide the following in-kind services to the Commonwealth, totaling approximately \$729,500 PER YEAR, but in no case would the approximation be less than \$725,000.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-FAC1-21: The Finance And Administration Cabinet Should Ensure Contracts Are Being Monitored For Vendor Compliance As Specified In The Contract (Continued)**

---

Radio and television spots associated with the University of Kentucky, University of Louisville and Western Kentucky University during football and basketball seasons. Estimated value = \$35,000

The Unbridled Spirit Logo will be advertised on the back of 150 delivery trucks a minimum of once a year. Estimated value = \$32,500

The Unbridled Spirit Logo will be placed on point of sale material, such as pole signs and shelf signage, in high-traffic retail locations. Estimated value = \$2,000

The Unbridled Spirit Logo will be placed on various products (cans, bottles, etc.) To be distributed throughout the commonwealth at various times during the year. Estimated value = \$650,000

The vendor will co-partner with a restaurant associate to provide coupons linked with the Kentucky state parks. Estimated value = \$10,000

3. Section 30.140 of the contract states:

One of the most important tools to monitor the contract's size and usage is by comprehensive reporting. This reporting will include each vendor's figures to include state agencies and political subs referencing the contract.

Below is a list of the reports that the Office of Material and Procurement Services requires each Vendor to provide and the frequency schedules:

**AGENCY LIST**

This report shall be a comprehensive list of all of the agencies and locations that are using the Soft Drink contract. This list shall include the name of the agency, the location, the county that it is located in and the account number or other identifying number used in billing. This report needs to be in Microsoft Excel format with each of the above as columns so that the Commonwealth personnel using these reports can sort the data in various ways for use in tracking agency participation. This report is required on a QUARTERLY basis until such time as the frequency may be changed. This report needs to be sent to the Commonwealth buyer on the 1<sup>st</sup> day of the second month following the quarter in question.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-FAC1-21: The Finance And Administration Cabinet Should Ensure Contracts Are Being Monitored For Vendor Compliance As Specified In The Contract (Continued)**

---

**VOLUME REPORT**

This report shall be a comprehensive list of data from each Vendor. This report shall include the following data elements: amount of scholarships provided during the year broken out by Governor's Scholars Program and the Office for the Blind; a list of the In-Kind Services provided during the year with a monetary dollar amount tied to them; the total amount of Commissions paid to the Commonwealth broken down by the agency and location and the means by which it was calculated so that the Commonwealth can reconcile that amount. The above report elements can be in a Microsoft Word document.

**PRODUCT USAGE**

To be created in Microsoft Excel format. The report shall show the total amount paid for Product by the Commonwealth to be broken down by the following columnar headings:

Agency name  
Agency location (address)  
County located in  
Specific use areas such as a specific State Park broken out by dining room, golf course, boat dock, campground, etc.  
Product category such as 12 ounce CSD, 2 liter CSD, etc.  
Usage per each category above in case quantities  
Dollar amount paid for those cases

Each of the Product Usage reports shall show a grand total of how many cases per Product category is being purchased, and a total dollar amount the Commonwealth is spending on Product. This report shall be submitted to the Commonwealth buyer on a QUARTERLY basis in Microsoft Excel format for ease of rearranging the data and distribution to other Commonwealth personnel.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-FAC1-21: The Finance And Administration Cabinet Should Ensure Contracts Are Being Monitored For Vendor Compliance As Specified In The Contract (Continued)**

---

**Recommendation**

We recommend the Finance and Administration Cabinet should:

- Ensure that the marketing program with the Commonwealth of Kentucky has been properly implemented. Information from the Commerce Cabinet-State Parks regarding the promotion of Kentucky Unbridled Spirit brand in association with the lodging that was to be offered by participating Parks and other documentation should be available from the Commerce Cabinet in regards to implementation of the marketing program.
- Contact the vendor and request the vendor to provide sufficient documentation to show that the In-Kind Services have been provided as required in Section 30.040 of the contract. Radio and Television stations should have records of airing of the commercials related to the Product (Pepsi) and the Kentucky Unbridled Spirit brand. Businesses that have carried the Product on store shelves and stores that have carried the cans and bottles displaying the Kentucky Unbridled Spirit brand should be able to verify whether they did in fact have these specially marked products on their shelves and that they had display signs for shelving, poles, and specially marked bottles cans and carton, etc.
- Contact the vendor and request the reports be filed as required in the contract and also notify the vendor that if the reports are not filed the vendor may be in breach of contract as stated in Section 130.040. The contract has been in place since October 1, 2005 giving ample time for the compiling of the information needed in the reports on a quarterly basis.

**Management's Response and Corrective Action Plan**

*The Finance and Administration Cabinet (FAC) disagrees with the following findings of noncompliance by the Auditor of Public Accounts (APA): (1) No documentation indicating that the marketing requirements as stated in Section 30.030 of the contract were being followed and properly implemented; (2) Based on discussions with agency personnel, no verification or documentation was provided for In-Kind Services as required in the contract under section 30.040. The costs to the Commonwealth are stated as no less than \$725,000 per year; and (3) None of the required reports were obtained for this contract as required under section 30.140 of the contract.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-FAC1-21: The Finance And Administration Cabinet Should Ensure Contracts Are Being Monitored For Vendor Compliance As Specified In The Contract (Continued)**

---

**Management's Response and Corrective Action Plan (Continued)**

*The Office of Material and Procurement Services (OMPS) and the Department of Parks (Parks) met with Pepsi on July 25, 2006 to discuss the marketing requirements of the contract, design and timing of marketing programs and tracking services. Pepsi provided Parks and OMPS (August 21, 2006) with an Unbridled Sprit Promotion Tracking Spreadsheet (attached) for the In-Kind services that have been provided. This information was also provided by Parks to the APA by email on December 14, 2006. Pursuant to the spreadsheet, Pepsi provided \$924,695.50 of In-Kind services to the commonwealth. This exceeds the amount of services required by section 30.040 of the contract (\$729,000) by \$195,695.50.*

*FAC believes that the participating agencies can best monitor the marketing and In-Kind services being provided, as they are also responsible for the design and implementation of the marketing programs with the vendor. FAC will continue to work with those agencies to ensure that services required by the contract are met. FAC will work with the participating agencies to reevaluate reporting requirements and ensure reports are submitted in a timely manner.*

**Auditor's Reply**

FAC did send the referenced documentation, "Marketing Value by Pepsi Bottler" in a December 14, 2006 email to the auditor; the auditor did not view this document as verification that the vendor, as specified in the contract, was meeting the marketing requirements. This document merely represents the vendor's planning of marketing programs and their associated costs for 2006. APA was not made aware of any meeting between the Department of Parks, OMPS and the vendor on August 21, 2006 to discuss marketing requirements of the contract, design and timing of marketing programs and tracking services. It would appear that one of the agenda items for the August 21, 2006 meeting would have been to evaluate the results of the marketing programs in 2006 to determine their success/failure in order to determine how best to proceed with the 2007 marketing program. In order to do this evaluation, there would have been a need for the vendor to produce the reports as required in the contract. It is noteworthy to comment that the meeting on August 21, 2006 is ten (10) months after the original contract was signed by the vendor. APA considers ten months as ample time for the vendor to have already developed and implemented procedures for these programs and for the Commonwealth to have been reviewing the results of the marketing programs for fiscal year 2006.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-FAC1-21: The Finance And Administration Cabinet Should Ensure Contracts Are Being Monitored For Vendor Compliance As Specified In The Contract (Continued)**

---

**Auditor's Reply (Continued)**

APA also asked for information relating to radio and television spots associated with the various sports broadcasts in an email dated December 16, 2006. In addition, in a January 4, 2007 email, from the Director of Marketing, Department of Parks, Pepsi was to follow-up with the Commonwealth on the documentation requested by the APA for the radio and television spots. As of this date, there has been no further documentation from the Department of Parks regarding the additional information from the vendor pertaining to radio and television spots that were to be carried out in 2006. Included in this email was a marketing schedule in anticipation of a meeting to be held in February 2007, for a March marketing program. It appears the same marketing techniques were presented in the March marketing promotions as were used in 2006; however, there is no actual documentation other than a spreadsheet to support FAC's position that the vendor actually performed the marketing programs in 2006. Additionally, the above document does not show any information or documentation related to the \$40,000 worth of lodging at various resort parks, to be provided by the Commerce Cabinet to the vendor to support the Kentucky's Unbridled Spirit brand.

FAC indicates, "the participating agencies can best monitor the marketing and In-Kind services being provided as they are also responsible for the design and implementation of the marketing program with the vendor." The auditor attempted to obtain reports that should have been filed between the date of the contract and the current date of the audit. A December 19, 2006 email from the Director of Purchasing, Department of Parks, indicates, "all agencies are using the contract, however the Department of Parks is the only agency having sales." In following up with the Department of Parks, the auditor received an email from the Director of Financial Operations, indicating, "PepsiAmericas does not provide quarterly statements on volume and usage to us." With this information from Parks, it is unclear to APA as to which agencies are participating in the contract and which agencies should be getting reports.

The failure of the vendor to provide any reports as required in the contract for the 2006 fiscal year should have alerted FAC that the vendor was not meeting contract requirements and that the renewal of the contract should not be automatic. It appears, though, since the vendor prepared marketing programs for March 2007, in anticipation of a February 19, 2007 meeting, that the contract was renewed and that the renewal occurred without the vendor meeting any of the reporting requirements specified in the contract for the previous year.



**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-FAC2-22: The Finance And Administration Cabinet's Division Of Fleet Management Should Implement Procedures To Investigate And Communicate All Potential Fleet One Card Discrepancies**

---

State Agency: Finance and Administration Cabinet

Finance and Administration Cabinet's Division of Fleet Management is responsible for the administration of the Fleet One fuel cards, which incurred expenditures totaling \$21,880,480 during FY 2006. During our review of procedures related to Fleet One transactions, we requested documentation to support Fleet Management's follow up of inconsistencies and errors identified on two reports generated monthly, the Mismatched Fuel Report and the Discrepancies Report. The Mismatched Fuel Report identifies instances in which the card used at the fuel pump does not agree to the fuel card listed for that specific vehicle in the system. Due to errors in reporting (incorrect license plates entered by the card user, for instance), this report identifies several hundred mismatched transactions per month. The Discrepancy Report identifies other types of inconsistencies - such as invalid license plates, invalid fuel cards, or fuel usage that exceeds the tank capacity for a vehicle. This report identifies approximately 50-80 discrepancies per month. Although the agency indicated that policies were in place during FY 2006 to follow up on discrepancies, it was unable to provide documentation to support the follow up of potential cardholder abuses identified on these two reports.

Based on information from Fleet Management, the agency's lack of supporting evidence may be attributed to workload issues and turnover of key personnel responsible for this function.

The failure to identify and follow up on potential abuses of Fleet One cards creates a greater risk for theft and misuse to go undetected.

Proper internal controls dictate that fuel charges and the use of Fleet One cards be monitored. The use of discrepancy reporting is a good tool to assist in this monitoring if proper review and follow-up procedures are in place.

**Recommendation**

We noted that additional procedures were implemented by Fleet Management in FY 2007 to track the follow-up of unusual transactions noted on the mismatched fuel and discrepancy reports. We recommend that Fleet Management continue these procedures, and consider implementing a formal written policy regarding the review of each item listed on the reports each month. Line items listed on the report in error (incorrect plate numbers, etc.) can be highlighted and explained, with all other items being cross-referenced to the follow-up report.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-FAC2-22: The Finance And Administration Cabinet's Division Of Fleet Management Should Implement Procedures To Investigate And Communicate All Potential Fleet One Card Discrepancies (Continued)**

---

**Recommendation (Continued)**

Additionally, when following up on potential abuses, Fleet Management should notify each agency contact in writing, even if phone calls have occurred. The written communication should indicate that repayment and disciplinary action is the responsibility of the agency's management. All correspondence (e-mails, letters, etc.) should be maintained.

**Management's Response and Corrective Action Plan**

*Fleet Management was responsible for payments totaling less than 50% of the total Fleet One fuel card purchases for FY 2006. The \$21,880,480 paid to Fleet One in FY 2006 included approximately \$10.5 million for Fleet Management; \$4.9 million for Transportation; \$3.8 million for the Justice Cabinet; \$1.7 million for Environmental and Public Protection; with the remaining \$1 million representing payments from various agencies and County governments.*

*The Fleet Management Administrative Section is currently in process of policy re-write that will be reviewed and incorporated into the updated Fleet Management Policy and Procedure manual update tentatively scheduled to electronically publish January 2007.*

*We have implemented an electronic filing system to track each vehicle discrepancy. It will contain all correspondence associated with the vehicle in question for that month. Fleet Management Administrative Section staff is responsible for this procedure. This procedure was put in place 12.17.2006.*

*Since approximately July 1, 2006, we have contacted each agency Point of Contact by letter. These letters are added to the electronic filing system noted above. Fleet Management Administrative Section staff is responsible for this procedure.*

*The repayment and disciplinary action responsibility will be incorporated into the Point of Contact notification letter. An example of the Point of Contact notification letter will be included in the tentative January 2007 Policy and Procedure manual update. The Fleet Management Administrative Section will complete. This will be effective 1.1.2006.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-FAC2-22: The Finance And Administration Cabinet's Division Of Fleet Management Should Implement Procedures To Investigate And Communicate All Potential Fleet One Card Discrepancies (Continued)**

---

**Management's Response and Corrective Action Plan (Continued)**

*Correspondence will be maintained electronically in the filing system noted above. This includes emails, written letters and notes taken during phone calls. Written communication will be scanned and stored. Fleet Management Administrative Section staff is responsible for this procedure. Effective date 12.18.2006.*

*We will continue to have plate number discrepancies until we acquire a functional system that does not immediately archive a license plate when it is taken out of service. For example, a vehicle is turned in by an agency. We mark it as "turned in" the day it is turned over to Fleet Management. This will stop the unit from being billed a monthly lease charge. Plate discrepancies will occur due to the plate number being placed in a non-active status. This non-active status will not allow any charges against a vehicle to occur for the month it is taken out of service. For example; if a vehicle is placed in a non-active status on the 28<sup>th</sup> of a month, more than likely, there will be fuel charges but no active status vehicle to charge against since the unit is in a non-active status. This will create an edit check when the monthly fuel data is processed. Fleet Management Administrative Section staff will investigate and correct the edit check. On completion, all pertinent data will be filed electronically. We experience an error rate of approximately one half of one percent vs. the number of fuel transactions each month. We diligently investigate each discrepancy due to the amount of potential dollars involved.*

*We will be sending electronic communications regarding discrepancy monitoring statewide to all state employees. These communications will notify recipients that Fleet Management does look at each individual fuel transaction for validity and will notify agency's management as well. Fleet Management will provide discrepancies and supporting information to agencies to aid in their investigation and implementation of disciplinary action if required.*

*Fleet Management will be publishing an updated Policy and Procedure manual. This is tentatively scheduled for January 2007.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-FAC3-23: The Kentucky State Police Should Improve Procard Controls**

State Agency: Finance and Administration Cabinet

As part of our FY06 FAC audit, we selected a sample of forty (40) ProCard expenditures to test for compliance from all state agencies, five (5) samples of which were from State Police. From our testing, we noted three (3) instances where multiple employees shared individual ProCards (3 of 5, 60%). Also, we found one (1) instance where the ProCard Administrator served as purchasing officer as well as made purchases with the ProCard (1 of 5, 20%). Even though the individual ProCard was not assigned to the ProCard Administrator and the individual ProCards were with cardholders the whole time, the ProCard Administrator kept the ProCard credit card number, expiration date, and security number in order to make purchases.

State Police ProCard Holder and Administrator are not familiar with, or disregarded, the FAP 111-58-00.

Ineffective internal control relating to compliance with FAP 111-58-00 and FAC Procurement Policies and Procedures could result in increased misuse of taxpayer funds and noncompliance with stated attributes.

- Section 2 of FAP 111-58-00 states “ An individual card embossed with an employee’s name shall be used exclusively by that employee and shall not be shared or loaned to other employees.”
- Section 2 of FAC Procurement Card Program Internal Procedures states “To ensure proper segregation of duties, procurement cards shall not be issued to Procurement Card Program Administrators, Procurement Card Administrators, and authorized signers.” In general, credit card numbers, expiration dates, and three-digit security numbers should not be revealed to anyone. Under these circumstances, ProCard Administrators should not make purchases with ProCard.

**Recommendation**

The Kentucky State Police should:

- Eliminate the practice of sharing cards and investigate the feasibility of obtaining custodian cards.
- Conduct a mandatory training session for cardholders and ProCard Administrators to describe the requirements and guidelines of FAP 111-58-00.
- Reassign duties so that ProCard Administrators do not need to order goods and services with a ProCard.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-FAC3-23: The Kentucky State Police Should Improve Procard Controls  
(Continued)**

---

**Management's Response and Corrective Action Plan**

*The Kentucky State Police has approximately 1,000 sworn officers assigned throughout the Commonwealth's 120 counties. The agency issues ProCards to officers in supervisory positions who oversee 1 to 100 officers under their command. The cardholder allows those officers to make approved and necessary purchases with their card (most often vehicle maintenance or repairs). In order for an officer to complete a ProCard transaction they must first contact the custodian to obtain approval. The custodian then provides the vendor with the ProCard number and any additional information needed to complete the transaction. Furthermore, the receipt is sent to the custodian for reconciling at the end of each billing cycle. It is not feasible to have the officer drive to the custodian's location (most likely a Post several counties away) or vice versa to complete such routine transactions. KSP has met with Ed Ross, Executive Director, Office of the Controller, in reference to this issue. Mr. Ross has stated that he has no issue with how KSP is conducting these transactions and will be giving the agency written approval to continue. Mr. Ross has suggested that KSP ProCard custodians sign each receipt when reconciling each cycle. KSP will be implementing this additional step in mid-September 2006.*

*KSP conducted mandatory training sessions for each cardholder and ProCard Administrator in February 2006. We feel this recommendation is a result of perceived violations of FAP 111-58-00, which was explained in our response above.*

*KSP agrees with this recommendation and will be implementing changes. The ProCard Administrator will no longer be ordering goods and services with a ProCard. This change will be implemented by Captain Brad Pratt, Commander of the Properties Management and Supply Branch. This change will take effect immediately.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-FAC4-24: The Finance And Administration Cabinet Should Develop And Implement Formal Policy And Procedures To Govern The Security Of The Management Administrative And Reporting System Checkwriter Interface Process**

State Agency: Finance and Administration Cabinet

The Finance and Administration Cabinet (FAC) has not developed or implemented a formal policy identifying responsibilities regarding security of Management Administrative Reporting System (MARS) Checkwriter (CW) interface datasets and processes. During FY 2005, the central level MARS security lead sent two listings to each agency; one verifying users authorized to request CWs be processed and another verifying user access privileges to the CW datasets. Along with these listings a document containing a description of how CWs are created, the steps for having them processed, and the importance of keeping update/alter access to datasets segregated from the authority to request CWs for processing. However, this document was not in the form of a formal policy and procedure document nor did it identify FAC and agency responsibilities over the segregation of duties concerning CW interface datasets and processes.

FAC Statewide Accounting Services (SAS) is responsible for processing of CW datasets/files and ultimately for ensuring access to CW datasets is reasonable. SAS must ensure that a proper segregation of duties exists between the creator of the CW datasets and the person submitting the datasets for processing through MARS. The SAS CW Coordinator provides oversight of this process. Our testing revealed that SAS did not perform the process to verify CW access during FY06 with the various agencies. Additionally, security weaknesses were noted involving nine individuals as follows:

- One individual was found with alter access to 39 CW datasets and authorization to request these datasets be processed. The auditor had requested that this individual's access to CW datasets be removed in the FY 2005 audit report.
- Three individuals were found with update access to CW datasets as well as authorization to request CW datasets be processed. One of these individuals was also noted in the FY05 audit report as not having their authorization verified through the agency.
- Three individuals remained on the SAS CW processing authorization listing as authorized to request CW dataset processing even though the authority had not been verified by the agency in FY05.
- Two individuals were on the SAS CW processing authorization listing as authorized to request CW dataset processing even though the agency had requested their authority to be removed.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-FAC4-24: The Finance And Administration Cabinet Should Develop And Implement Formal Policy And Procedures To Govern The Security Of The Management Administrative And Reporting System Checkwriter Interface Process (Continued)**

---

Furthermore, both the central level MARS security lead and SAS CW Coordinator maintain lists of authorized CW processing requestors. Our examination revealed that the list of users authorized to have CWs processed maintained by the MARS security lead did not correspond with the list maintained by SAS CW Coordinator, who uses the list to approve CW processing.

Allowing users the ability to update/alter CW datasets and authorize their processing increases the likelihood of unauthorized processing of CW payments and may compromise the integrity of data processed through the Advantage system. A lack of formalized procedures concerning the CW dataset access and processes have led to inconsistent understandings between the agency, management, and users with regards to individuals who have CW dataset access and may authorize processing. Further, the procedures that have been documented do not provide guidance on assuring user listings are updated and verified on a periodic basis by requiring verification be sent to the responsible agency.

Formally implemented policy and procedures concerning dataset access and CW processes are required so that management and users from FAC and the agencies will have a clear understanding of respective responsibilities and ensure the reasonableness of individual access to the CW datasets and processes.

**Recommendation**

We recommend that FAC establish documented formal policy & procedures to govern the security surrounding CW datasets and processes. This effort should include standardized procedures for update and synchronization of lists maintained by the SAS CW Coordinator and central level MARS Security identifying users authorized to initiate CW processing and access to the CW datasets.

**Management's Response and Corrective Action Plan**

*Due to the nature of dataset security being administered at the departmental level, we continuously had trouble coordinating who had access to their datasets when we approved personnel to authorize the release of the file. In eMARS the separation is very straightforward. The process begins with a letter to the Controller requesting the establishment of a file ID and the IDs of the individuals authorized to upload their file from their network servers. Separate security is requested for IDs to be authorized to run the pre-edit job on the file and departmentally certify the file. The upload capability has a security role to only view the Checkwriter Header Table and the certification security role has access to act on the file. After department certification, SAS personnel act on the file and can see the IDs of both individuals to see if they are ever the same as a secondary check.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-FAC5-25: The Office Of Financial Management Should Develop And Implement Policies To Ensure Accounts Are In Compliance With Applicable Laws**

State Agency: Finance and Administration Cabinet

During the investment income audit, we reviewed the statutory authority for accounts receiving investment income within the State Investment Pool. This authority is documented on the SAS-14 form, which is prepared by the Governor's Office for Policy and Management (GOPM). We randomly selected nine (9) accounts from the 614 line items in OFM's earnings database. These line items were either new accounts, or accounts changed (regarding receipt of interest, or investment pool) in 2006. In 5 of 9 instances tested (55%), non-specific authorizations were cited. Also, there was no review performed to ensure authorized accounts receive interest.

GOPM currently is responsible for communicating to OFM and FAC regarding account setup and change details, and account interest authorization via SAS-14 forms. The statutory reference on this form specifies the account's authorization to receive or not receive interest.

OFM's responsibilities include accounting for investment pool balances, division/allocation of investment income among funds, and ensuring that investment income is accurately reported and authorized.

For FY07, account changes and interest authorization is documented in eMARS. The account or interest authorization information documented should be adequate to determine the specific authorization for accounts receiving interest income. We are unable to determine compliance of account authorization because the SAS-14 forms did not cite specific statutory references. Due to this method of documentation, it is also unclear how OFM is meeting its responsibility to review the statutory authorization.

Similar problems with the non-specific account authorization and OFMs lack of review were noted in the FY05 audit findings 05-FAC5-19 and 05-FAC6-20.

The cause of the weakness is a lack of documented procedures for reviewing investment income authorizations.

The effect of these problems is that an account could receive interest income that it is not entitled to receive, or an account that should be receiving interest income, is not. In other words, accounts could be noncompliant with respect to interest authorization if no procedures are implemented to ensure proper authorization and recording of interest income.



COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-FAC5-25: The Office Of Financial Management Should Develop And Implement Policies To Ensure Accounts Are In Compliance With Applicable Laws (Continued)**

---

Management should have adequate internal controls in place to provide reasonable assurance that account changes/authorizations are reviewed and that subsequent postings of investment income are in compliance with applicable laws and regulations. Internal controls should ensure accounts allowed to receive income are receiving that income and accounts disallowed are not.

**Recommendation**

We recommend that policies and procedures be created and implemented to ensure that accounts are in compliance with applicable statutes. These policies should include a review of statutory authority per change authorizations on accounts.

**Management's Response and Corrective Action Plan**

*The Office of Financial Management (OFM) and the Office of State Budget Director (OSBD) have created and implemented policies and procedures to ensure that accounts are in compliance with applicable statutes regarding interest income.*

*As stated in OFM's response to a similar FY05 recommendation, it is the responsibility of OSBD to approve the accrual of interest income and to document the appropriate statute, regulation, federal law or rule, or other authority.*

*It is then OFM's responsibility to set up the account so that it either receives interest income or does not, as directed by OSBD in compliance with the statutes or other authority. OFM respectfully disagrees that OFM should, for this purpose, also review the statutory authority cited by OSBD on SAS-14 forms.*

*As to non-specific account authorization, the following accounts were listed in the Auditor's review as having insufficient information on SAS-14 forms:*

<u>SAMPLE ACCOUNT</u>	<u>"POST-TO" ACCOUNT</u>	<u>COMMENTS</u>
<i>1300-860-BO-BKO-BK00 or policy stated</i>	<i>0200-765-1A-120-0120</i>	<i>"IRS' non specific reason; no statute</i>
<i>0200-670-IT-156-0156 policy, reason stated</i>	<i>0200-765-1A-120-0120</i>	<i>inactivated on 6/28/06, no statute,</i>
<i>0200-C36-3E-049-6049 or policy stated</i>	<i>6300-750-XX-XXX-SP85</i>	<i>"IRS'- non specific reason, no statute</i>

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-FAC5-25: The Office Of Financial Management Should Develop And Implement Policies To Ensure Accounts Are In Compliance With Applicable Laws (Continued)**

---

**Management's Response and Corrective Action Plan (Continued)**

<u>SAMPLE ACCOUNT</u>	<u>"POST-TO" ACCOUNT</u>	<u>COMMENTS</u>
0200-470-GN-342-0342	6300-750-XX-XXX-SP85	'IRS'-non specific reason, no statute or policy stated
0200-415-4B-006-0006	6300-750-XX-XXX-SP85	'IRS'-non specific reason, no statute or policy stated

*We will respond to the first two individually and the last three collectively.*

*1300-860-B0-BK0-BK00 - The comment referenced by the review, "IRS", is not what the SAS-14 form dated April 15, 2005 reflects. The "Reason or Statute/Policy" section reads: "HB 272, sec 70" which is the enabling legislation authorizing the account to earn interest income.*

*0200-670-IT-156-0156 - This account did not have authority to accrue interest income, so there is no statute, policy, reason to be stated, except that the comment referenced by the review "inactivated on 6/28/06" is the action taken to be in compliance.*

*0200-C36-3E-049-6049; 0200-470-GN-342-0342; and 0200-415-4B-006-0006 - The comment referenced by the review, "IRS", is characterized as "non-specific". We respectfully disagree. This requirement is imposed by the federal government for the privilege of issuing bonds that are exempt from federal income taxes and lowering the cost of borrowing for the Commonwealth. There is not a corresponding state statute, so the federal law is the applicable legal source. The rules governing tax-exempt borrowing can be found in Internal Revenue Service Code section 148 and 149. The shorthand "IRS" applies always and only to state projects established and funded with tax-exempt bonds. Because this is a "default" requirement for those funds, it remains our contention that the "IRS" reference is specific as it can only have one meaning. (OSBD, in prior communication with the Auditor's office, has explained that the only time the IRS is referenced as the reason for accruing interest income is when tax-exempt bonds are the source of funding for the capital project account.)*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-FAC6-26: The Finance And Administration Cabinet Should Improve Segregation Of Duty Controls**

---

State Agency: Finance and Administration Cabinet

As has been noted in the previous four audits, OFM did not employ proper segregation of duties between the programming and operation functions. During the first half of FY 2006, the programmer was also functioning as the operator for the Microsoft Access programs used within the Commonwealth's Cash and Investments System. These duties included running automated daily programs and manually running the macros within the month end programs on a routine basis. In addition, the programmer made manual adjustments to a key database that affected other routines and data results. The programmer also made program changes and placed modified program directly into the production environment.

Beginning December 1, 2005, the Accounting/IT Supervisor reduced the programmer's access to a 'Read Only' level. As a result, another member of the OFM staff was assigned to perform month end processing until it could be automated. Also, the Accounting/IT Supervisor assumed the data librarian duties and is now responsible for daily processing and moving changes into production. In addition, the programmer no longer has the ability to modify the production databases. The programmer is now responsible for determining what adjustments need to be made and the Accounting/IT Supervisor reviews and approves these, prior to placing them into production.

Even though significant issues were identified, OFM was proactive in addressing our concerns related to segregation of duties during the course of this audit. We are also aware of certain "uncontrollable" circumstances that have hindered this effort. At the time of our testing, month end processing could not be automated due to software version limitations. Further, training issues and staff turnover delayed removal of the programmer from processing responsibilities. However, during our fieldwork the programmer's access was restricted and OFM has implemented a new processing computer. Further, we understand that automation of the monthly processing is planned in the near future.

Employing strong segregation of duty controls decreases the opportunity for unauthorized modification to files and programs, and decreases the likelihood of errors or losses occurring because of incorrect use of data, programs, and other resources. These control weaknesses identified only existed during the first half of FY 2006.

Computer programmers should not have direct access to the production version of program source code or be able to directly affect the production environment. The reason for this control is to ensure that the programmer does not intentionally or unintentionally introduce unauthorized or malicious source code into the production environment. Smaller organizations that cannot easily segregate programmer duties from computer operator duties should implement compensatory controls to supervise programmer activities to ensure only properly tested and authorized programs are migrated into production.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-FAC6-26: The Finance And Administration Cabinet Should Improve Segregation Of Duty Controls (Continued)**

---

**Recommendation**

We recommend that OFM ensure the Month End processing is automated. Someone other than the programmer or person reconciling the Month End reports should be responsible for this processing. Also, now that a new processing computer has been implemented, OFM should ensure the programmer's access to the production environment is restricted to a "Read Only" level. Management should continue to thoroughly review all adjustments and program changes deemed necessary by the programmer to ensure they are appropriate prior to processing.

**Management's Response and Corrective Action Plan**

*The Office of Financial Management agrees with the recommendation. As noted above, OFM has already taken the necessary steps to implement the recommendation. We have limited the programmer's access to the production environment to "Read Only", someone other than the programmer or person reconciling month end is responsible for month end processing, and the Accounting Section Supervisor continues to review and approve all necessary program changes.*

*We recently received a new processing software package. We will be converting the month end processing to the automated processing software within the next few months.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-FAC7-27: The Finance And Administration Cabinet Should Strengthen Logical Security Procedures Surrounding The Complete Asset Management, Reporting, And Accounting System**

---

State Agency: Finance and Administration Cabinet

As noted during the previous two audits of the Commonwealth's Cash and Investments System, the Office of Financial Management (OFM) did not properly secure the critical financial data associated with the distribution of earnings from Commonwealth investments. Also, OFM has not developed or implemented a formalized security policy that identifies management and user responsibilities concerning IT security surrounding the Cash and Investments System.

Our examination revealed that an OFM computer programmer had full access control to the production library during the first five months of FY 2006. This level of access not only allowed the programmer unlimited access to the old Statistical Analysis System based programs, but also to the current Access databases and programs used in production. The Accounting/IT Supervisor was made aware of this situation on December 1, 2005, at which time the programmer's access level to the production library was reduced to a 'Read Only' level and additional security measures were taken to further secure several databases that are used in production.

It was also noted that the same computer programmer had full access control to the Complete Asset Management, Reporting, and Accounting (CAMRA) software and data files maintained in a separate data library during the first six months of FY 2006. This situation occurred due to a software issue that prevented OFM from changing the programmer's IDs on the previous processing computer without causing processing errors. However, once a new processing computer was installed in January 2006, the programmer's access to CAMRA and related data files was changed to 'Read Only'.

Without strong, formalized, logical security controls, the opportunity increases for unauthorized modification to production files as well as the likelihood of errors or losses occurring from incorrect use of data and other resources.

Formalized security policies set the tone of management concern for strong system security and provide a security framework used to educate management and users on their responsibilities. System security should be administered in such a way as to ensure proper segregation of duties. System access should be limited to the level necessary for performing assigned duties. Granting users system access that would allow the ability to alter or delete programs or financial data prior to or subsequent to processing increases the risk of financial misstatements or fraudulent reporting.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-FAC7-27: The Finance And Administration Cabinet Should Strengthen Logical Security Procedures Surrounding The Complete Asset Management, Reporting, And Accounting System (Continued)**

---

**Recommendation**

We recommend that OFM develop and implement a formalized security policy that standardizes security responsibilities for all employees and ensures critical programs and data are properly secured. OFM should ensure that programmers are not allowed access to the production library or to the CAMRA software and related data files. Further, management should continue to monitor all current employee's access levels to ensure access levels ensure a proper segregation of duties and do not allow inappropriate access to production data. This review should be thoroughly documented for audit purposes.

**Management's Response and Corrective Action Plan**

*The Office of Financial Management agrees with the recommendation. As stated above, OFM has limited the programmers' access to the production library and CAMRA data files to "Read Only". In addition, the Accounting Section Supervisor currently performs a monthly review of the access levels of all employees to production data. The supervisor will ensure documentation of the review is maintained for audit purposes.*

*The Accounting Section Supervisor will begin compiling a formalized security policy and will attempt to have it implemented by the end of the fiscal year.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-FAC8-28: The Finance And Administration Cabinet Should Formalize And Consistently Apply The Program Modification Process For The Commonwealth's Cash And Investments System**

---

State Agency: Finance and Administration Cabinet

As noted during the previous audit of the Commonwealth's Cash and Investments System, the Office of Financial Management (OFM) has a program modification process in place; yet, this process had not been formalized in standards or procedure statements specific to the agency. OFM converted their programs from Statistical Analysis System versions to Microsoft Access versions on July 1, 2005. For the FY 2006 audit, we examined changes made to the Statistical Analysis System programs used in production between December 2004 and June 2005, due to the timing of our prior year audit. We also examined the changes made to the new Access programs and databases from inception throughout FY 2006 to date.

With regards to Statistical Analysis System, we identified 541 changes, 12 of which, or 2.2 percent, were not supported by a Program Change Request (PCR) or considered a 'general maintenance' change. In addition, there were 351 changes identified within the 541 instances of code changes, or 64.9 percent, that the auditor would consider meeting the requirements of a general maintenance program change. Though these are considered maintenance type changes, an email or other authorizing or requesting correspondence should still support those changes. These noted changes were not supported by e-mail or other communication of the issues to be resolved, code comparisons identifying the changes made to the program, or an approval from a person other than the programmer to make the changes and move them into production.

Since the implementation of Microsoft Access as the primary processing system on July 1, 2005, the program modification process has significantly improved. Specifically, a log has been developed in order to track PCRs. In addition, OFM has modified the PCR to reflect the types of changes being made to the current Access database environment. Among the steps associated with the PCR, the supervisor's approval is required to ensure that the requested change is necessary, the proposed coding change is reasonable, and the altered program code has been sufficiently tested for accuracy and applicability to the requested change. Once all of these approvals have been placed on the PCR, then a final approval to move the change into production must be applied. Furthermore, the details of the change are recorded along with a list of the impacted tables, queries, and macros if the change directly impacts one of the processing databases.

An examination of documentation maintained in support of the program modifications to the new Access system revealed that there were eleven PCRs completed during FY 2006. It was noted that the programmer did not provide appropriate approval for three these, or

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-FAC8-28: The Finance And Administration Cabinet Should Formalize And Consistently Apply The Program Modification Process For The Commonwealth's Cash And Investments System (Continued)**

---

27.3 percent of the population. Also, there were a total of 188 individual code changes made and 174 of those were properly documented and authorized. Three of the remaining 14 code changes could be matched with changes requested on two PCRs, but the specific processes affected were not detailed, as they should have been on those PCRs. The remaining 11 code changes were not supported by any correlating PCR.

Without a formalized program modification process and monitoring of the compliance with the process, the agency is at risk that procedures that are deemed vital to the process will be overlooked. For example, disregarding the procedure established to review supporting documentation for evidence that a change has been tested and approved for promotion to production could circumvent the control in place to limit programmer access to the production environment. This increases the likelihood that unauthorized or inappropriate program changes could be placed in production.

The program modification process should be formalized, distributed, and understood by all applicable agency personnel. This process should be consistently applied to all code changes to existing programs and the development of new programs.

**Recommendation**

We are aware that the agency has made significant strides toward improving their program modification process, yet we continue to advocate the following recommendations in order to improve the current process.

We recommend that OFM formalize, implement, and consistently apply control procedures over the program modification process. Specifically, the agency should, at a minimum:

- Develop a formal procedure manual for the program modification process. This manual should include the procedures to adequately document program specifications and understanding of program objectives, to specifically identify changes in code by maintaining both the pre-modified copy of the database and the revised copy, to properly complete the PCR form, to adequately test proposed program code changes, and to verify that all approvals are in place for the program code change before implementation to the production environment. If emergency situations are anticipated that might require this process to be accelerated, then that



**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-FAC8-28: The Finance And Administration Cabinet Should Formalize And Consistently Apply The Program Modification Process For The Commonwealth's Cash And Investments System (Continued)**

---

**Recommendation (Continued)**

should be taken into consideration and an alternative process developed that properly applies compensating controls over that accelerated process.

- Consistently apply the formalized program modification process.
- Ensure requirements include procedures to ensure that an individual other than the programmer properly reviews all changes for accuracy and that proper approvals are documented authorizing implementation of the change into production before the librarian moves the change to the production environment. After implementation of changes, the librarian should sign and date the PCR form to affirm that this process has been completed.
- If there are changes that relate to a 'general maintenance' PCR form, ensure that the programmer provides supporting documentation for the request of the program changes, inclusive of an e-mail or other communication of the issues to be resolved, identification of the specific program code that was changed to satisfy the request, and approval from a person other than the programmer to move the changes into production. All personnel involved with authorizations of the PCR form.

**Management's Response and Corrective Action Plan**

*The Office of Financial Management agrees that a procedures manual needs to be created for the program change request process. The Accounting Section Supervisor will begin compiling a procedures manual on this topic. During the compilation, the recommendations noted above will be taken into consideration along with the feasibility of each.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-KRSY1-29: The Kentucky Retirement System Should Ensure Internal Controls Are Adequate To Prevent Overrides**

---

State Agency: Kentucky Retirement System

During the fiscal year ended June 30, 2006, two officers of Kentucky Retirement Systems' (KRSY) Executive Management, the Chief Investment Officer, and the Chief Operations Officer, circumvented internal control policies and procedures related to an Alternative Investment made by the KRSY Insurance Fund.

The Chief Investment Officer and the Chief Operations Officer also failed to perform adequate due diligence in violation of agency practice and industry best practice related to an Alternative Investment by the KRSY Insurance Fund. In addition, the Chief Investment Officer and the Chief Operations Officer acted outside the authority granted to them by the Investment Committee when completing the acquisition of the Alternative Investment.

In addition, there was a commingling of funds between the Pension and Insurance Funds to finance the acquisition of the Alternative Investment. This is in violation of the Plan Document and the Internal Revenue Code.

**Management's Response and Corrective Action Plan**

*The Chief Investment Officer and the Chief Operations Officer have resigned. KRSY has retained fiduciary counsel, Ice Miller, LLP, to review the internal controls in place and will issue an opinion regarding the internal controls at KRSY and make recommendations, if necessary.*

*Also, the Audit Committee of the Board of Trustees of KRSY has directed Internal Audit to review internal controls and make recommendations, if necessary. In the interim, it is the opinion of the Executive Management of KRSY and Internal Audit that the internal controls are adequate.*

*Furthermore, Ice Miller, LLP, is in the process of preparing a memorandum with respect to the Alternative Investment and the commingling of funds to detail the self-correcting action taken by KRSY.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-KST1-30: The Department Of Treasury Should Only Process Wire Transfers For Which Sufficient Funding Exists**

---

State Agency: Department of Treasury

During the month of June 2006, a wire transfer request for \$6,100,871.40 was issued by the Cabinet for Health and Family Services on WT000024036. This document was adequately approved at the agency level and was approved in MARS by Finance on June 16th. The wire transfer request form was then approved by a Treasury employee and was faxed to Farmers Bank for processing on June 19<sup>th</sup> at 8:00 AM (a finding and recommendation were issued over this particular process - see 06-KST2-31). Treasury's approval on the MARS document was then applied in the accounting system at 9:44 AM. However, this document was rejected in MARS due to inadequate funding at the agency level, yet the wire had already been processed at the bank. Even though the wire had been sent from the bank, the transaction was not recorded in the State's accounting system until August, which is in the next fiscal year.

The wire rejected in MARS because adequate funding did not exist for the transaction, and this error was not discovered until June's reconciliation was performed in August (see finding and recommendation on this issue in 06-KST4-33). It was explained that sometimes wires must be processed prior to approval in MARS as Treasury must be flexible so that payment can be made timely to avoid possible penalties. In this specific situation, however, the payment was already eighteen days past due (although the late payment was not Treasury's fault).

In this specific situation, the effects include: 1) a six million dollar payment was made without sufficient funding at the agency level, 2) had this error not been caught, FY06 expenditures would have been understated and cash would have been overstated by six million dollars in the CAFR, and 3) FY07 expenditures would have been overstated by six million dollars. Additionally, since many wires are often processed for significantly larger amounts, it is conceivable that should this type of error occur at year-end, it could cause a material misstatement within the CAFR, which would be misleading to users of the State's financial statements.

Good internal controls dictate that wires only be sent when adequate funding exists and after appropriate authorizations have been received. In addition, internal controls should be in place to detect and prevent a material misstatement of the financial statements.

COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-KST1-30: The Department Of Treasury Should Only Process Wire Transfers For Which Sufficient Funding Exists (Continued)**

---

**Recommendation**

We recommend that Treasury only process wires for which adequate funding exists and appropriate authorizations have been obtained. In addition, we recommend that a Treasury supervisor closely examine the year-end reconciling items from the June bank reconciliation to determine if any adjustments are necessary for financial reporting purposes.

**Management's Response and Corrective Action Plan**

*Under normal circumstances, the recommendations of the Auditor in this comment would have been followed. This is basically the process that is in place. However, the month of June 2006 and the following months were far from normal. The Commonwealth converted to an entirely new accounting system (eMARS), and Farmers Bank converted to a new web-based Execubanc System and a totally new account structure required by eMARS. In addition, the Treasury Department's Accounting Branch personnel changed with the retirement of a long-time, key employee. It has been a difficult transition.*

*The normal procedure in processing wire transfers is to receive the "Request For Wire Transfer" document by fax from the requesting agency and then to locate the referenced document in the accounting system (in FY '06 MARS ,now eMARS). The WT document in MARS was compared to the faxed "Request For Wire Transfer" document information. If they agreed, the WT document was approved by the Treasury. The wire transfer was then entered into the Execubanc transfer system by the Accounting Branch personnel, approved by a supervisor, and transmitted electronically to Farmers Bank. If the Execubanc System was not functioning, the wires were faxed to Farmers Bank.*

*On 6/19/06, all wire instructions were faxed to Farmers Bank, indicating that the Execubanc System was not functioning properly on that date. This was a frequent occurrence in June as Farmers Bank transitioned to its new operating system. The old system encountered many problems, which were not resolved because of the pending transition.*

*In this case the wires were faxed before the accounting documents were viewed and released in the accounting system. If the accounting system is down and cannot be accessed to verify the amount on the transfer requests faxed to the Treasury, the wires must go out anyway. Wire transfer payments are time sensitive. Serious*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-KST1-30: The Department Of Treasury Should Only Process Wire Transfers For Which Sufficient Funding Exists (Continued)**

---

**Management's Response and Corrective Action Plan (Continued)**

*repercussions and penalties oftentimes ensue if payment deadlines are missed. These daily wires usually include federal income tax and FICA deposits, payments to universities to fund payrolls and operating expenses, and, in the case of the wire mentioned in the comment, a payment to the Federal Reserve Bank of New York for a Medicare contribution. The repercussions of missing these payments are much more serious for the state than any accounting problems that may result in improperly processed accounting documents. The wire transfer system must retain enough flexibility to allow these payments to be made, even when the central accounting system is not accessible.*

*It is important to note that the wires sent out in this manner under emergency situations when the accounting system is not available for comparison are routine wires in which the payees are well known to the personnel of the Treasury Department and Farmers Bank. Payments to a new or unknown recipient would be questioned and verified before the wire would be sent.*

*When the MARS document rejected because of insufficient agency funding, a correction should have been initiated immediately. Unfortunately, the new Treasury employee handling this did not recognize this or take the necessary steps to notify all affected parties. A Treasury employee more comfortable with the electronic processing system has now been moved into that job. The error should also have emerged on the reconciliation for June 30. However, that reconciliation has been delayed because of the transition to the new central accounting system. The Treasury Department does not yet have access to the documentation necessary to do a complete monthly reconciliation. The establishment of a new reconciliation process is dependent upon the project staff members of the eMARS project. We remain hopeful that that process will be developed in the near future.*

*In summary, the recommendations made by the Auditor are ordinarily followed. In normal circumstances, the failed wire transfer document would have been discovered and corrected immediately. As a fail-safe, it would have appeared in the monthly reconciliation for June. However, with the implementation of eMARS, very few of the normal processes were functioning during the transition to the new accounting system on July 1, and detection was delayed. We do not anticipate this type of situation occurring again once the new reconciliation system is in place.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-KST2-31: The Department Of Treasury Should Improve Controls Over The Disbursements And Computer Application Access/Modification Processes**

State Agency: Department of Treasury

While performing tests of controls over receipts and disbursements, we noted the following segregation of duties concerns:

- Two employees in the Department of Treasury Accounting and Disbursements Division are authorized to send wire transfers. During our review, we noted that most wires are reviewed and approved by a supervisor and then entered into Execubanc by one of these employees. Some wires, however, are processed outside of this typical process. To process these wires, a "Wire Transfer Request" form is faxed directly to Farmers Bank by one of the two employees, and a supervisor's review and approval is not required. These same employees also are the only employees who perform the bank reconciliation at Treasury.
- At least two employees have access to a template of a blank check that contains the Treasurer's signature. These employees also have access to blank check stock. Based upon our inquiries, checks can be issued or reissued using this template and an independent review of the check is not performed after issuance.
- The Director of Computer and Technical Services is the only employee who is authorized to and has access to make programming changes to Treasury's software. In addition, this same person also has read, write, and change authority for live data in MARS which would indicate inadequate segregation of duties between the programming and operation functions.

Although these opportunities existed during FY06, nothing came to our attention that would suggest that any transactions were questionable, were falsely recorded, or were not appropriate.

This weakness in the design of these internal controls at Treasury is the result of a lack of oversight and inadequate staffing. The Department of Treasury processes over nine million transactions annually representing over fifteen billion dollars (excluding wire transfers).

Inadequate segregation of duties over wire transfers and blank check stock increase the risk that funds could be misdirected and not detected in a timely manner.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-KST2-31: The Department Of Treasury Should Improve Controls Over The Disbursements And Computer Application Access/Modification Processes (Continued)**

---

Also, employing strong segregation of duty controls over computer programming and operations decreases the opportunity for unauthorized modification to files and programs, and decreases the likelihood of errors or losses occurring because of incorrect use of data, programs, and other resources.

Good internal controls dictate that the functions of recording, authorization, and custody of assets be segregated to prevent a person from being in a position to possibly commit and conceal fraud. They also dictate that manual disbursements be adequately reviewed and approved by a supervisor to ensure necessity, accuracy, and completeness.

Furthermore, proper internal controls dictate that software users be prohibited from having access to source code, the compiler, and programming documentation.

**Recommendation**

During our audits, although we did not have any indication of fraudulent activity at Treasury, we recommend management consider implementing the following recommendations to help reduce the risk of misstatements, whether due to error or fraud:

- We recommend that personnel sending wires not reconcile wire activity during the bank reconciliation process. Should this not be a viable option with Treasury's current resources, we recommend that a detailed review be performed of the bank reconciliation (especially the section dealing with wires) at the supervisor level. In addition, controls should be improved over the wire process. We recommend that Farmers Bank be instructed not to process a faxed wire without the same levels of authorization that exist in the Execubanc System, which requires two levels of approval.
- We recommend that Treasury segregate duties so that employees with access to check stock and check templates do not have access to signature plates without appropriate approval and review.
- We recommend that Treasury not allow programmers to process transactions in MARS/eMARS, or implement sufficient compensating controls to supervise programmer activities.
- Additional staff resources should be allocated to the Department of Treasury.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-KST2-31: The Department Of Treasury Should Improve Controls Over The Disbursements And Computer Application Access/Modification Processes (Continued)**

---

**Management's Response and Corrective Action Plan**

*It is not feasible with current budget and staffing for the Treasury Department to segregate the processing of wire transfer activity from the reconciliation function. Both are the responsibility of the 2 person Treasury Accounting Branch. There are no other personnel who can do this.*

*On August 23, 2006, the Treasury Department instructed Farmers Bank not to process a faxed wire unless it was signed by both the employee initiating the wire and a Treasury Department Supervisor. Signature samples of the authorized supervisors were included in the instructions to the bank. The Treasury Department also re-emphasized the policy that, whenever possible, wire transfer instructions to Farmers Bank should be entered into the on-line Ecorp System (the successor to Execubanc).*

*The blank check template in Microsoft Word used for reprinting checks is currently under password protection, and is only available to four Treasury employees. That template does not contain a signature. The signing process is separate, and the signature stamp is kept under lock and key. Treasury will identify staff to review all reissued checks.*

*The Director of Computer and Technical Services is the only AS/400 Programmer working in the State Treasurer's Office. With the staff and resources available, the type of segregation of duties envisioned by the Auditor, while theoretically desirable, is not possible.*

*The Treasurer would welcome the allocation of additional staff resources and the funding to support that staffing to accomplish the type of segregation of duties deemed desirable by the Auditor.*

*Furthermore, Treasury is following the standard practices that have been approved in the past by the Auditor's Office, practices that comply with the statutes and are sound public policy. These practices are not new and have never been identified as problematic in previous audits. In fact, Treasury views the current audit comments as being inconsistent with prior audit results, without justification in applicable audit standards or applicable Kentucky law. After auditing the same policies and procedures, the fiscal year 2005 Audit found no exceptions with Treasury's operations.*



**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-KST2-31: The Department Of Treasury Should Improve Controls  
Over The Disbursements And Computer Application Access/Modification Processes  
(Continued)**

---

**Auditor's Reply**

Regarding the Director of Computer and Technical Services' MARS/eMARS access, if segregation of duties is not possible, Treasury should implement other compensating controls to mitigate the risks in this area. For example, program modifications should be logged and reviewed for adequacy by another employee with sufficient understanding and authority.

Also, to address the last paragraph of the management response, during our audits, we rotate internal control testing on a periodic basis and certain controls may not be tested each year. Therefore, it is possible to have significant internal control weaknesses in the year under audit that were not detected in previous years.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-KST3-32: The Department Of Treasury Should Develop A Disaster Recovery Plan And Ensure Adequate Documentation Is Stored Off-Site In The Event Of An Emergency Situation**

---

State Agency: Department of Treasury

While auditing the internal controls over the processing of cash receipts by the Kentucky Department of Treasury, we requested to review Treasury's Disaster Recovery Plan as well as the contract in place for disaster recovery services. We were informed that a Disaster Recovery Plan was drafted and reviewed a few years ago, however, a copy could not be produced. The contract for Disaster Recovery services (effective June 16, 2006) was produced; however a copy of the contract that was effective prior to June 16 (more than 95% of FY06) could not be located. This would indicate that the contract either was not in place or was misplaced. Also, the Disaster Recovery Plan and contract for disaster recovery services as well as documentation on how to install and operate Treasury's key software are not currently stored off-site in case of emergency.

The cause of not having these key documents is not known, although it should be noted that the Department of Treasury was completely relocated during the move from the Capital Annex to their current facility.

Since these key documents were not found after multiple requests over several weeks, the documents likely would not have been located timely in the event of an emergency situation. Additionally, when the state's accounting system was switched from MARS to eMARS in early FY07, there was an increased risk that a system failure could create the need for data recovery. Should an unfortunate or unforeseen event temporarily or permanently disrupt Treasury's current facilities or ability to operate, the effect could range anywhere from an inconvenience to significantly and adversely impacting the Commonwealth's operations.

Good internal controls dictate that contingency plans exist for alternative processing in the event of loss or interruption of the IT function. In addition, copies of the contract for disaster recovery as well as backups of master files, transaction files, applications, application documentation, and other key Treasury documents should be stored off-site.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-KST3-32: The Department Of Treasury Should Develop A Disaster Recovery Plan And Ensure Adequate Documentation Is Stored Off-Site In The Event Of An Emergency Situation (Continued)**

---

**Recommendation**

We recommend that Treasury prepare and test a formal Disaster Recover Plan and store key documentation (such as a copy of the plan, copy of the contract for disaster recovery services, backups of master and transaction files, backups of applications, copies of application documentation, list of personnel and their contact information, etc.) at an off site facility to minimize the effect of a disruption in Treasury's and the State's operations in the event of an emergency situation.

**Management's Response and Corrective Action Plan**

*As Director of I.T., I fully understand the importance of a Disaster Recovery and Business Continuity plan. Supporting documentation has been found that confirms the contract for disaster recovery services was in place for the majority of fiscal year 2006. The contract had a start date of July 1, 2001 and ended on January 31, 2006. I have been in contact with our current Business Continuity partner (IBM) to recreate this plan, as well as contacted additional companies to evaluate their services to determine if they can provide additional support to ensure that the operations of the Kentucky State Treasury continue, in case of an unexpected disruption.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-KST4-33: The Department Of Treasury Should Reconcile Commonwealth Bank Accounts With MARS In A Timely Manner**

---

State Agency: Department of Treasury

The Department of Treasury performs a reconciliation of the state's bank accounts to MARS on a daily and monthly basis. During FY06, the reconciliations for the month of May, however, was not performed in a timely manner. In addition, the June reconciliation was not completed at all.

There are a number of factors that have caused this, including: 1) key employee turnover in the Accounting Section due to retirement, and 2) the implementation of eMARS, the State's new accounting system, in July 2006.

Bank accounts that are not reconciled promptly could result in oversights, errors and miscalculations that misstate account balances for financial reporting purposes. For example, during June 2006, a multi-million dollar wire was sent from the bank that was not discovered until the June reconciliation was attempted in August. This error would have misstated expenditures and the cash balance in the accounting system for FY06 had it not been detected and corrected. In addition, due to unreconciled differences between cash and the financial accounting system, there is an increased risk of not having cash invested efficiently, resulting in a loss of income.

Good internal controls dictate that the state bank accounts be reconciled in a timely manner. Daily reconciliations should be performed within a day or two of the actual occurrence; monthly account reconciliations within two weeks after the necessary system reports are run after the end of the month.

**Recommendation**

Treasury should take appropriate steps to ensure that daily and monthly bank reconciliations are performed timely. We understand that the state's change in accounting systems from MARS to eMARS has made this process more difficult, however every effort should be made between Treasury and Finance to reinstitute the reconciliation processes as soon as possible.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-KST4-33: The Department Of Treasury Should Reconcile Commonwealth Bank Accounts With MARS In A Timely Manner (Continued)**

---

**Management's Response and Corrective Action Plan**

*The State Treasurer's Office is very cognizant of its responsibilities in the reconciliation of the state's bank accounts. Efficient reconciliation has been one of the hallmarks of the office for many years, and a source of great pride. The reconciliation timelines recommended by the State Auditor are written into the performance evaluation standards of the employees of the Accounting Branch, and with few exceptions those employees have exceeded those standards significantly every month. The employees have actually competed with themselves to see how quickly they could get in balance each month. This sense of pride in their jobs makes the current reconciliation issues described by the Auditor frustrating to the Treasury staff.*

*The problems for May and June are both related to the transition to the new central accounting system, eMARS. The May reconciliation, which very quickly was brought to within approximately \$19,000, was not completed in a timely manner because additional research was needed from the Controller's Office, and the personnel to conduct that research were totally absorbed in the system conversion and were not available. The un-reconciled difference was not under any objective standard, but the Treasurer's Office does balance to the penny each month.*

*In June, many-year end MARS transactions for FY '06 were intertwined with FY '07 beginning eMARS transactions, particularly during the first days of July. Old year and new year transactions were running at the same time. The Treasury Department still has not been provided, by Finance, a way to identify and extract the eMARS data from the MARS data to close out FY '06 completely. Again, we do know with some confidence that there are no undetected material differences which would skew the 2006 data. We just are not able at this point to balance exactly.*

*The eMARS accounting package purchased by the Finance Cabinet did not come with a bank reconciliation module that would meet the state's needs. As occurred with the introduction of MARS in 1999, a whole reconciliation system will have to be developed. In 1999 it took more than a year to reconcile the state's bank accounts, and this was only accomplished with the creation of a task force of Treasury, Controller's Office, and contract employees who finally created a new system and identified all of the sources of data needed. We do not believe that eMARS reconciliation will take quite this long, for the system created in 1999 still*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-KST4-33: The Department Of Treasury Should Reconcile  
Commonwealth Bank Accounts With MARS In A Timely Manner (Continued)**

---

**Management's Response and Corrective Action Plan (Continued)**

*largely applies. The issue is identifying the sources of the data needed in eMARS. This can only be done by the project experts in the Controller's Office and the contractor, CGI-AMS, working with the Treasury Department Staff. Unfortunately, we are at their mercy as to when they have time to approach this task.*

*The Treasury staff and supervisors monitor the bank accounts closely on a daily basis to catch any errors or inappropriate activity. Check exceptions, electronic debit and credit transactions, wire transfers, and other types of transactions are identified and corrected each day. Other tasks are closely reviewed. It is hoped that these processes will keep down the prospect of material errors occurring until a complete reconciliation process is available. The ultimate source of error detection is, however, the monthly bank reconciliation. The Treasurer is eager to get that system in place. Treasury Personnel are working with the eMARS experts to identify the sources of data that are needed, and to get all reconciliation queries pointed to that data. It has been a slow process, however, because of the multiple problems that have been encountered statewide with this conversion. We hope that this process will be completed soon in 2007.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-PERS1-34: The Department Of Personnel Should Implement Formal Policies Governing System Access To The Group Health Insurance And Premium Billing And Reconciliation Systems**

---

State Agency: Department of Personnel

The Department of Personnel Administration (Personnel) did not develop and implement formal logical security control policies and procedures concerning the Group Health Insurance (GHI) system and Premium Billing & Reconciliation (PB&R) systems.

Discussions revealed that, based on job responsibilities, Personnel employees and contractors must complete and submit a properly authorized user access request form. These requests are normally submitted electronically via email from the supervisor or authorized person to the System Management Branch (SMB) staff. The SMB staff member name or initials assigned to complete the access provision is placed at the bottom of the form. These forms are maintained electronically in email format by respective agencies. Our examination revealed that all user access forms were not maintained and most of those on file were not completed properly. We requested the Network/Server Access Request Forms (SARF) for all of the forty-two current users. Thirty-three of the requested access forms were not available. Eight of the forms were on file but the assigned SMB staff member completing the access provision was not indicated. Only one SARF form was complete and without exceptions. Therefore, even the established informal procedures were not consistently applied.

Failure to adequately document, implement, and communicate acceptable computer security policies and procedures could lead to a lack of understanding by management and users that might result in a failure to comply with security policies, failure to perform assigned security responsibilities, or inappropriate and inefficient use of system resources. This increases the likelihood of unauthorized or inaccurate data modification, destruction of assets, interruption of services, or inappropriate or illegal use of system resources.

Formalized policies should be established for logical system access controls to help ensure only authorized users are granted access to the GHI and PB&R systems. Consistent application of formalized security policy and procedures provides continuity and sets the tone of management concern for strong system controls. These policies should include requirements for management authorization of access requests; procedures for requesting new system access, changes to existing system access, termination of system access, and documentation of appropriate authorization for system access and subsequent changes. Additionally, system users should be made aware of their responsibilities concerning data confidentiality, as well as appropriate and efficient usage of system resources. Security access request forms should be maintained in a manner that is organized and readily accessible by the security administrator.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-PERS1-34: The Department Of Personnel Should Implement Formal Policies Governing System Access To The Group Health Insurance And Premium Billing And Reconciliation Systems (Continued)**

---

**Recommendation**

We recommend that Personnel develop and implement formal policies and procedures to administer the logical security of the GHI and PB&R systems, and ensure those procedures are consistently applied. Security access request forms should be completed and properly maintained for all current and new users, including all necessary information and proper authorizations. These policies and procedures, once developed, should be properly distributed and all system users made aware of their responsibilities concerning system access.

**Management's Response and Corrective Action Plan**

*The Personnel Cabinet agrees with the recommendation and as mentioned above, we are in the process of adapting the procedure that is used in UPPS change control to fit this environment. This procedure will ensure that all program areas will be required to submit a change request form to the Systems Management Branch.*

*We will also make sure that we have updated security forms on current users and make every effort to maintain them in the future. The time frame is expected to take a couple of months to implement the change control process and to update all the existing security records.*



**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-PERS2-35: The Personnel Cabinet Should Adhere To Established Procedures Governing System Access Requests For The Uniform Payroll And Personnel System**

---

State Agency: Department of Personnel

The Personnel Cabinet did not adhere to established procedures concerning logical security governing the Uniform Payroll and Personnel System (UPPS). Specifically, these procedures require each employee to complete an access request form to ensure that UPPS users are provided sufficient access to this mission critical system. Based on job responsibilities, state employees must complete a user access form and obtain approval by the requestor's supervisor. Our review revealed that all user access forms were not maintained on file and some of those on file were not complete or properly authorized.

We selected a sample of access request forms for twenty-five new UPPS users. Of the access forms selected, thirteen of them were not maintained on file. Twelve of the forms were electronically archived on file but only eight of the access forms were complete and without exceptions. Two of the forms did not include the required security date and one of those did not have supervisor approval, which should be provided when the user's access is granted or when a change is made to the user's access level. Further, two other forms found on file were applicable to older deleted IDs for the tested users, but no forms could be located concerning those users' current IDs. Based on our test results, control issues were noted with 52 percent of the forms tested.

Further, three Personnel Cabinet employees were authorized for update access to the UPPS security file. During our review, update access to this file had been provided to one additional non-Personnel employee. The security staff stated this access had been provided inadvertently for testing purposes but they also contend that this level of access would have been denied by the system because the access was established using the wrong organization code. However, this is still considered an exception since a review of the security file had not been performed by the security staff to identify users with unauthorized access at this level.

Allowing unauthorized users update access to the UPPS security file could severely affect the reliability of the security controls established for UPPS. Allowing users the ability to access information without proper authorization may subject the processing of data to errors and/or omissions and may compromise the integrity of data processed through the Uniform Payroll and Personnel System.

The foundation of logical security is access control, which refers to how the system is being accessed and by whom. Formal policies provide a security framework to educate management and users of their security responsibilities.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-PERS2-35: The Personnel Cabinet Should Adhere To Established Procedures Governing System Access Requests For The Uniform Payroll And Personnel System (Continued)**

---

Consistent application of formalized security policies and procedures provides continuity for implementation and sets the tone of management concern for strong system controls. Further, the level of system access granted to users should be restricted to only areas necessary for an employee to perform assigned job duties.

**Recommendation**

We recommend that the Personnel Cabinet consistently apply the established logical security policies and procedures applicable to the granting of UPPS system access to new users. Access request forms should be completed for all new users and should include all necessary information and appropriate authorizations.

**Management's Response and Corrective Action Plan**

*The Personnel Cabinet agrees with the recommendation and will make every effort to be more diligent in following the established logical security policies and procedures when granting user access to the UPPS system. We will ensure that all new requests for user's access will include the necessary information, appropriate signatures and copies will be maintained on file. The time frame to implement this procedure will begin immediately.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-REV1-36: The Department Of Revenue Should Work With COT To Strengthen Controls Governing Data Processing Of Taxpayer Accounts**

---

State Agency: Department of Revenue

The Department of Revenue (Revenue) did not implement an adequate process for balancing the Tax Receipt System to the Commonwealth's Management Administrative and Reporting System (MARS). Our examination revealed that the report used by Revenue to post electronic payments to the Tax Receipts System, to balance the electronic receipts with MARS, and to post receipts to taxpayer accounts through the Compliance and Receivables System (CARS), REREP108, was not developed in a manner that would allow that report to be used effectively for these processes performed by Revenue. Testing revealed that the REREP108 report does not reflect dollars refunded to taxpayers and also revealed delays between postings to MARS (creation and posting of the C1E document indicating actual receipts of funds), and the time those funds are reported on the REREP108 report.

At the time of our fieldwork in April 2006, tax receipts associated with electronic payments posted to Revenue's Tax Receipt System and MARS were irreconcilable. Testing revealed that the REREP108 report used to perform these processes did not include a data field common to the electronic payment gateway, the Tax Receipts System, and MARS that could be used to track and identify variances between the systems. Further, though the agency was aware of the variances and was working toward a solution to the problem, they were not aware that a common linked field could be used to generate a report that would identify information necessary to help properly balance the Tax Receipt System with MARS. The transactions in discrepancy were simply noted as errors and were carried forward instead of correctly identifying the reasons for the variances. These variances fluctuated throughout the year as some timing differences cleared themselves. The net variance noted for the fiscal year through March of 2006 ranged approximately from \$100,000 to \$300,000 in receipts. Further, at the time of our fieldwork in April, the agency could not specify whether these issues would also affect posting of payments to CARS.

During our review, Revenue met with the auditor to identify a report that would include a field to allow individual transactions to be tracked from the initial electronic payment transaction through actual recording within MARS allowing a proper reconciliation between the Tax Receipt System and MARS to be performed. We acknowledge that Revenue has been working with the Commonwealth's Office of Technology (COT) to resolve issues surrounding the processing of electronic tax payments and that some progress has been made in identifying the source of the discrepancies between tax receipts processed by Revenue and the tax receipts posted in MARS.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-REV1-36: The Department Of Revenue Should Work With COT To Strengthen Controls Governing Data Processing Of Taxpayer Accounts (Continued)**

However, as of the end of FY 2006, Revenue continues to use the same RREP108 report for posting to the Tax Receipts System, processing data through CARS, and to attempt to reconcile with MARS.

The process of using the RREP108 report as a tool for posting tax payments to Revenue's Tax System and to balance with MARS is inaccurate and inefficient. This report currently does not reflect the actual posting of settled receipts as captured in MARS. Timing and other issues cause variances between this report and postings within MARS that cannot be accurately identified and explained. Further, the failure to properly investigate and reconcile variances resulting from this process illustrates a lack of due diligence and effects the integrity of data that could lead to inaccurate tax notices and penalties. At a minimum, using the RREP108 report for posting to the Tax Receipt System could result in the unnecessary expense of researching and correcting errors regarding taxpayer accounts.

The organization should establish procedures for assuring that data input is reconciled to the relevant control totals. Audit trails should be provided to facilitate tracing transaction processing and the reconciliation of data. The organization should establish proper procedures to resolve variances or errors noted using control total balancing to ensure the complete and accurate posting of transactions to the system. Transactions should be input and processed within critical systems in a timely fashion.

**Recommendation**

We recommend Revenue continue to work with COT to identify all sources of the discrepancies between the Tax Receipts System and MARS, to identify any effect on associated taxpayer accounts, and to make any and all corrections to taxpayer accounts if necessary. Further, we recommend that Revenue continue to pursue methods to generate a new report or to alter the current RREP108 report so that a more functional report is available for posting tax receipts to the Revenue Tax System and CARS. This report should include a data field that assists in reconciling the amounts posted from the report with those posted within MARS. Based on our examination the Merchant Order Number within the ePayment table and the transaction sequence number that is currently being used within the RREP108 report are key linking fields. A report with this additional information will aid in the reconciliation of these systems and help ensure that receipts posted within Revenue's Tax System agree with actual settled receipts posted in MARS. In addition, we recommend that Revenue work with COT to

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-REV1-36: The Department Of Revenue Should Work With COT To Strengthen Controls Governing Data Processing Of Taxpayer Accounts (Continued)**

**Recommendation (Continued)**

determine whether issues identified with the RREP108 report are affecting CARS posting and correct postings as needed.

If needed, comparable data reports should be developed and implemented for processing through CARS to ensure the integrity of the payment data processed through that system and ultimately the tax accounts. Finally, Revenue should determine causes for delays between posting in MARS and posting within Revenue systems and ensure corrective actions are taken as necessary to alleviate any posting delays.

**Management's Response and Corrective Action Plan**

*Revenue agrees with the auditor's findings and recommendations and will continue to work with COT to make improvements in this area. Revenue will work to have procedures documented once clear, accurate methods are developed.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-REV2-37: The Department Of Revenue Should Ensure Access To  
Production Libraries Is Limited**

---

State Agency: Department of Revenue

Our FY 2006 audit of logical access controls for the Department of Revenue (DOR) revealed that DOR had not adequately restricted access to its production libraries. Our testing revealed thirteen Commonwealth Office of Technology (COT) computer operators were provided alter access to a DOR production load library. Although the COT computer operators are responsible for migrating programs into production from this library for DOR, they use a software application for this purpose that only requires read access to the library to perform the move. Therefore, these computer operators do not need the alter access to this load library.

A recent merging of the DOR and COT within the Finance and Administration Cabinet has resulted in many information technology employees previously located within the Revenue Cabinet relocating within COT. Because of these employee relocations, new user profiles had to be established and in the process it appears these COT computer operators were provided alter access to the load library by DOR.

Organization of the information technology functions should be structured such that the highest possible segregation of duties is achieved. Access to production load libraries should be restricted to ensure only properly authorized programs are available to be migrated into production environments. User access should be limited to the minimal access required for completion of assigned job duties. Optimally, a librarian function is established as the only user allowed to move programs into a load library to ensure proper logical access security. This prevents computer operators from having authority to introduce unauthorized programs into the library and subsequently into the production environment. If computer operators are allowed more than read access to load libraries for emergency purposes, then provision of such access levels should be temporary, the reason well documented, and their activities should be closely supervised.

**Recommendation**

We recommend that the DOR security administrator work with COT to ensure the computer operator access to DOR production libraries is limited to the minimal access necessary for the operators to perform their job. Only in emergency conditions, with close supervision and documentation, should COT operators be provided greater than read access to the Revenue production libraries.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-REV2-37: The Department Of Revenue Should Ensure Access To  
Production Libraries Is Limited (Continued)**

---

**Management's Response and Corrective Action Plan**

*While we agree any access should be granted with least privilege access in mind, changing such access cannot be performed without due process and evaluation of the potential outcome. Revenue will work with COT to review and document the current access and identify where access can be altered to alleviate this issue while continuing to allow for the COT Production area and Revenue Business requirements to succeed. As indicated in the July 28, 2006 email response from COT to the Auditor's Office, this issue will be reviewed to see if we can in fact modify current permissions without adversely affecting business.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-REV3-38: The Department Of Revenue Should Ensure That Formal Program Modification Control Procedures Are Developed And Implemented**

---

State Agency: Department of Revenue

Our FY 2006 audit of the Department of Revenue (DOR) program modification controls identified the absence of adequate policies and procedures governing the authorization, logging, and tracking of program change requests submitted to the Commonwealth Office of Technology (COT).

COT currently manages the change management process for DOR. Specifically, all DOR program changes are handled through submission of the COT-F001 form to the COT Office of Application Development (OAD). Once received, the form is logged and assigned for completion based upon the nature of the request. However, DOR should establish controls to ensure their requests are properly authorized, logged, and tracked to ensure timely accurate completion of requests by COT. The DOR Director is responsible for authorizing and submitting changes to COT. DOR has not established formal policies or procedures to ensure these agency level controls are met.

In addition, though DOR does not maintain a log the COT-F001 forms submitted to COT, COT does maintain such a log. Review of this COT "change log" revealed that there were 289 DOR change requests that were indicated on the log as being open requests. Therefore it is evident that DOR has a significant number of requests that should be monitored through implementation of adequate formal program change control procedures.

Failure to establish and to consistently apply proper program modification control procedures increases the risk that incorrect or unauthorized changes to critical applications could be placed into the live production environment and adversely affect processing results for the DOR systems.

Program modification control procedures should be established and consistently applied in order to ensure that only appropriately authorized changes to critical applications are made and implemented within the production environment. Requests for all critical changes should be formally documented for proper tracking to ensure desired objectives are achieved in a timely manner. The proper authorization chain should also be documented in order to ensure that all requests are properly authorized prior to changes being migrated into a production environment.



**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-REV3-38: The Department Of Revenue Should Ensure That Formal Program Modification Control Procedures Are Developed And Implemented (Continued)**

---

**Recommendation**

We recommend that DOR establish and implement formalized program modification policies and procedures governing the authorization and monitoring process for change requests submitted to COT. The policies and procedures should include a formal process for tracking COT-F001 forms sent to COT in order to ensure that changes are completed in a timely manner.

**Management's Response and Corrective Action Plan**

*The Department of Revenue agrees with the Auditor's findings in regard to the need for the implementation of formalized program modification control procedures governing the authorization, logging, and tracking of all program change requests submitted to COT. The Department is in the process of establishing policies and procedures in regard to authorization, logging, and tracking of all program change request submitted to COT. Controls will be established to ensure that all requests are properly authorized and tracked to ensure that desired objectives are achieved timely and accurately. One employee within the Commissioner's Office will be responsible for maintaining a log of all COT-F001's requested by DOR, verifying that all requests are properly authorized, tracking the status of request and participating in all meetings between COT and DOR concerning any change request.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-REV4-39: The Department Of Revenue Should Implement Procedures To Protect Cigarette Tax Stamps**

---

State Agency: Department of Revenue

The Department of Revenue (DOR) has failed to establish adequate internal controls over tax stamps. DOR received \$165,310,066 for the cigarette excise tax and surtax during FY06; this was 1.9% of General Fund receipts. Existing controls take into account neither the importance of the tax revenue nor the vulnerability of the stamps to theft: both physical security over the stamps and the system of records need improvement, and segregation of duties should be implemented.

DOR staff members accidentally mailed six rolls of 30,000 stamps to the wrong address, but only five of the rolls were returned. The missing roll had a tax value of \$9,000.

Three DOR field offices sell cigarette tax stamps. The most popular format is rolls of 30,000 stamps that are delivered in boxes of 25 rolls. All locations are supposed to sell stamps on the first-in-first-out principle. However, one field office empties one box before going on to the next, the order in which it uses the boxes appears random. This complicates tracking the stamps by serial number.

Cigarette tax stamps are portable due to their small size, and they might be sold if stolen. Consequently, DOR should maintain stringent internal controls over them. The need for good controls appears to have been overlooked because the amount of money collected when the tax was \$0.03 per pack was comparatively small; however, the surtax imposed by the legislature beginning June 1, 2005 increased the cigarette tax rate tenfold. Despite the magnitude of the tax revenue, the DOR maintains inadequate records vulnerable to changes that leave no audit trail, stores the stamps in a location where dozens of people have access to them, and fails to employ segregation of duties.

DOR has also failed to maintain sufficiently tight security over the vault where the stamps are stored. Because virtually all employees know the vault key is kept in a desk drawer in the mailroom, we must assume that everyone in the office has access to the vault and to the cigarette stamps stored in it. The largest stamp format is a roll of 30,000 in a box measuring approximately 2" x 2" x 12". A box of these stamps with a tax value of \$9,000 could be readily concealed and carried outside the vault. The vault camera provides virtually no protection for the stamps because it covers only the vault door, not its interior.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-REV4-39: The Department Of Revenue Should Implement Procedures To Protect Cigarette Tax Stamps (Continued)**

---

The records maintained on cigarette tax stamps are deficient in three respects. First, they are kept in a spreadsheet program. Entries and changes require no approvals, and no electronic or paper log of them is generated. Next, no records focus on accounting for each individual sheet or roll of stamps. Tracking each serial number helps assure that no stamps have been mislaid or misappropriated. Finally, no reconciliation of stamp sales to tax revenue takes place.

DOR has failed to implement appropriate segregation of duties. A single individual has been assigned responsibility for approving sales to cigarette wholesalers, taking stamps from the vault to package shipments, and keeping records of the sales and stamp serial numbers. This employee also assists in the physical inventory count of the stamps and performs a reconciliation of the count to the records. Assigning all those responsibilities to the same individual makes it possible to carry out a theft and conceal it by altering the records.

The incident of the misdirected stamps prompted an internal review of the procedures to obtain, secure, sell, and account for cigarette tax stamps. The review report performed by the Assistant Director in the Special Investigations Division dated March 9, 2006 contained recommendations to improve these procedures. All but two of those appear in the recommendations below; the exceptions are the establishment of a second log (the apparent purpose of this is tracking individual sheets and rolls of stamps, which is covered in recommendation 3) and expanding the spreadsheet to include wholesaler names and license numbers (this appears to be unnecessary duplication of records maintained). To date the DOR has put into place only the proposal to conduct a monthly physical count of the stamps. As implemented, however, the new procedure fails to employ the recommended segregation of duties. One of the people assigned to conduct the inventory is the employee who has primary responsibility for cigarette tax stamps, not (as recommended) someone independent of the cigarette tax stamp process. This employee also reconciles the physical count to the recorded sales.

The cause of the out-of-order sales of stamps at one field office is failure to exercise care in the storing and use of the boxes of stamps.

The reported value of cigarette stamps stored in the vault was \$137,135,980 on June 30, 2005 and \$97,939,541 on June 30, 2006. This is the amount of revenue at risk if the stamps were to be stolen and subsequently used by unscrupulous dealers.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-REV4-39: The Department Of Revenue Should Implement Procedures To Protect Cigarette Tax Stamps (Continued)**

---

Good internal controls protect more than assets; they also protect the reputations of the employees who handle those assets. Failure to implement segregation of duties means that the employee who handles the stamps would automatically fall under suspicion if stamps were ever mislaid or stolen.

Segregation of duties prevents theft except in cases of collusion. While very small organizations may find it necessary to implement compensating controls because there are too few people to implement this key control, DOR is large enough to apply segregation of duties in all key areas. The functions of custody (physical access to the stamps, taking the inventory count), authorization (approval of orders), and record keeping (recording sales, reconciling inventory) should rest with different individuals or departments. At present a single individual performs all these duties.

DOR has a fiduciary duty to protect the state's liquid assets. Cigarette tax stamps are a liquid asset, easily concealed and readily marketed, so they should be stored in a secure environment. Maintaining reliable records is another essential safeguard.

**Recommendation**

We recommend that the DOR adopt the following procedures:

1. Assign responsibility for the monthly physical inventory count and reconciliation to two individuals whose other duties do not involve cigarette tax stamps.
2. Strengthen vault security. (This is addressed in greater detail in a separate finding.)
3. Request that COT establish a database for cigarette tax stamp records. This should feature appropriate controls and create a report that tracks each sheet or roll from the time of receipt to shipment to field office (if applicable) to shipment to a wholesaler.
4. Implement internal audit procedures to cover cigarette tax stamps that include reviews of the inventory stored in all four locations.
5. Enforce consecutive sales of cigarette tax stamps at all field offices. Ordinary care in stacking new deliveries and selecting the next box to open is all that would be needed to implement this.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-REV4-39: The Department Of Revenue Should Implement Procedures To Protect Cigarette Tax Stamps (Continued)**

---

**Recommendation (Continued)**

Recommendations one through four are based on those found in the report mentioned above dated March 9, 2006 from the Assistant Director in the Special Investigations Division.

**Management's Response and Corrective Action Plan**

*On the recommendation of the assessment done by the Department's Special Investigations Division and the Auditor of Public Accounts, procedures are being developed and put in place to ensure the security of the cigarette stamps at the DOR offices that hold an inventory of cigarette stamps. This will include segregation of duties. Procedures have been implemented at the Taxpayer Service Centers to ensure FIFO sale of stamps. Research is being conducted on the recommendation to have COT develop a database for cigarette stamp inventory control.*

**Auditor's Reply**

In addition to the incident reported above, DOR received notice on September 28, 2006 that two rolls of cigarette tax stamps, each with 30,000 stamps, were missing from a shipment made via a commercial carrier. The Director the Division of Special Investigations conducted an investigation, and the report dated October 9, 2006 concluded that the probable cause was damage to the box used to ship the order. While it appears that theft did not occur, this subsequent event highlights the stamps' vulnerability to loss or theft and the importance of implementing a strong system of controls. Based on this additional information, we also recommend that DOR use sturdier packaging and review shipping methods to further reduce the risk of intentional or unintentional damage or loss.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-REV5-40: The Department Of Revenue And Office Of State Budget Director Should Ensure That Tax Receipts Belonging to County Governments Are Properly Accounted For In The Fiduciary Fund At Year End**

---

State Agency: Department of Revenue

The Department of Revenue (DOR) collects several types of property taxes; some of these taxes include both a state portion and a local government portion. Both the state and local share are deposited into the General Fund. Periodically DOR distributes the local government share after first transferring it to the Special Deposit Trust Fund using journal vouchers. Local governments receive the fiscal year's last payment in August of the next fiscal year. Previous audits noted inconsistency in the timing of the year's last journal voucher transfers from the General Fund to the Special Deposit Trust Fund. The transfer occurred before June 30 in 2000, 2001, 2004, 2005, and 2006, but after June 30 in 1997, 1998, 1999, 2002, and 2003.

Prior audit findings addressed the importance of consistency in financial reporting. A closer examination of this issue indicates that revenue recognition is a problem here. The local property taxes collected by the state are fiduciary funds owed to another entity, not state funds. By leaving them in the General Fund for several weeks or months after collection General Fund receipts and fund balance are overstated until the transfer to the Special Deposit Trust Fund takes place. When the transfer takes place after a new fiscal year has begun, the General Fund has improperly recognized revenue

The MIXERS tax system is not set up to credit the local government share of property taxes to the Special Deposit Trust Fund upon receipt. Revenue from four tax types [General Property Tax-Real (R251), General Property Tax-Tangible (R252), Public Service Companies Tax (R260), and Apportioned Vehicle Property Tax (R266)] is instead credited to the General Fund upon receipt. Multiple journal vouchers transfer a share of the tax revenue from the General Fund to the Special Deposit Trust Fund as tax type General Property Tax-Tangible Motor (R253). The tax revenue recorded in the Special Deposit Trust Fund is then distributed to local governments. Similarly, a transfer takes place for tax type Omitted Tangible Property Tax (R265) from the General Fund to the Special Deposit Trust Fund, although the tax type did not change.

A FY04 comment (04-REV-6) noted the inconsistency between the property tax transfer timing in fiscal years 2003 and 2004 and recommended adoption of a consistent policy. In its response DOR agreed to work with the Office of the State Budget Director (OSBD) to establish a policy on transfer timing. OSBD issued a letter dated May 25, 2005 establishing a policy that in essence means the handling of journal vouchers will be guided by the fiscal condition of the Commonwealth on June 30 of each year. This policy fails to address the auditor's concern with accurate and consistent financial statement presentation. The management response to the second finding consisted of the portion of the May 25, 2005 letter that discussed the policy's rationale.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-REV5-40: The Department Of Revenue And Office Of State Budget Director Should Ensure That Tax Receipts Belonging to County Governments Are Properly Accounted For In The Fiduciary Fund At Year End (Continued)**

---

Because MIXERS does not credit the local government share of property taxes to the Special Deposit Trust Fund upon receipt, these fiduciary funds are mingled with governmental funds (the General Fund).

Whenever the transfer is made after June 30, General Fund receipts and fund balance are overstated. Fiduciary assets and liabilities for the Special Deposit Trust Fund are understated if the transfer occurs after June 30.

In response to the FY04 finding, DOR and OSBD adopted a policy to vary the timing of the transfers according to year-end budgetary considerations; in other words, to include money that is the property of local governments in General Fund receipts in order to show a balanced budget or trigger surplus spending. This is improper revenue recognition and a violation of GAAP. Adopting a policy that allows this encourages management to manipulate financial reporting.

As written, the policy adopted by the OSBD could result in inaccurate and inconsistent financial reporting. Depending on the timing of the transfer in any given year, the General Fund and Special Deposit Trust Fund could be overstated or understated by the amount of the fourth quarter transfer. This would result in inconsistent financial presentation for analysis and policy purposes, and could also result in a misstatement in the financial statements for both funds.

GAAP requires each fund to recognize revenue in the appropriate accounting period and fund. Section 7.344 of the GASB Comprehensive Implementation Guide says the following when it addresses the issue of a government's use of one of its funds as a clearing account for property taxes:

**Q**—A county tax collector collects property taxes for all taxing bodies in the county, including the tax-levying funds of the county. The county uses an agency fund as a distribution mechanism for the taxes. At year-end, the collector is holding \$3,450,000 in the tax distribution account. Of that total, \$750,000 will be distributed to the county funds, and the remaining \$2,700,000 represents taxes collected for the other taxing bodies in the county. How does the county apply the "clearing account" provision in paragraph 111 of Statement 34 for agency funds for agency funds?

**A**—In the county's financial statements, the tax collector's agency fund would report only the \$2,700,000 in cash with an equal amount as a liability to other taxing bodies. The \$750,000 collected and on hand for the county's funds would

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-REV5-40: The Department Of Revenue And Office Of State Budget Director Should Ensure That Tax Receipts Belonging to County Governments Are Properly Accounted For In The Fiduciary Fund At Year End (Continued)**

---

be reported as cash (rather than taxes receivable or due from agency funds) in the appropriate funds. In essence, the collector has a “pooled” cash account, similar to an internal investment pool. The allocation of cash balances to the county funds is consistent with the requirement in paragraph 14 of Statement 31 that requires the “equity position” of each fund in an internal investment pool to be reported as assets in those funds.

The GASB Statement 31 requirement on reporting the equity position of each fund means the local government property tax share should never be reported within the General Fund. Therefore, the transfer of these amounts to the Special Deposit Trust Fund should take place before the fiscal year ends.

The present policy established by DOR and the OSBD anticipates inflating General Fund revenues by delaying the property tax transfers, thus creating the appearance of budgetary compliance when it does not exist. This violates GAAP, as explained in the preceding paragraph.

We recognize that FAC and OSBD have specific statutory duties to properly manage the financial affairs of the Commonwealth, including compliance with budgetary requirements. Controlling expenditures, making realistic revenue estimates, and monitoring activity throughout the year are the proper ways to discharge that duty. Manipulating financial reporting is not a legitimate method of budgetary control. Even though the transfers were appropriately recorded during FY06, the policy permits inconsistent treatment because the timing will vary with changes in budgetary needs. Financial statements should be prepared in a manner that provides accurate, comparable data for its users.

**Recommendation**

We recommend that DOR modify its MIXERS system to transfer the local government share of property taxes to the Special Deposit Trust Fund upon receipt. It should also incorporate this feature into the Comprehensive Tax System now under development.

Until DOR systems are able to do this, we recommend that DOR transfer the local share of property taxes to the Special Deposit Trust Fund no later than June 30 of each fiscal year.



**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-REV5-40: The Department Of Revenue And Office Of State Budget Director Should Ensure That Tax Receipts Belonging to County Governments Are Properly Accounted For In The Fiduciary Fund At Year End (Continued)**

---

**Management's Response and Corrective Action Plan**

*If the situation arises where the Department of Revenue is directed to initiate journal voucher transfers after June 30, it will ensure that Form AFR 35 is completed as part of the closing package, which will account for the transfer as part of the CAFR procedures; as a result the financial statements will not be misstated. The modification of the MIXERS system as recommended by the Auditor would be a very expensive endeavor and is not feasible at the present time. The recommendation made by the Auditor to incorporate the transfer of local government property tax funds upon receipt to a Special Deposit Trust Fund in the Comprehensive Tax System will be reviewed for consideration by the Department.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-TC1-41: The Kentucky Transportation Cabinet Should Ensure That Logical Security Procedures Are Consistently Applied For The Trns\*port SiteManager System**

---

State Agency: Transportation Cabinet

The Kentucky Transportation Cabinet (KYTC) Office of Information Technology (OIT) did not adhere to established logical security procedures controlling access to the SiteManager module within the Trns\*port application.

Established security procedures for SiteManager require, as noted on the KYTC SiteManager ID Request form, that the user's supervisor complete the access request form and submit it to the SiteManager system administrator. We selected a sample of 78 users from a population of 699 active SiteManager users to assure that properly approved access request forms had been completed. Our testing revealed the following issues:

Eight of the access request forms were not on file and could not be provided by KYTC. Nine request forms were incomplete, lacking the supervisor name and contact information.

Failure to consistently apply logical security controls could lead to a lack of understanding by management and users that could result in a failure to comply with security policies, failure to perform assigned security responsibilities, or inappropriate and inefficient use of system resources. This situation increases the risk of unauthorized data modification, destruction of assets, interruption of services, or inappropriate or illegal use of system resources. Without maintaining authorization documentation for users within a system, management cannot definitively support a user's access privileges.

Established security policies and procedures should be consistently applied to provide continuity for policy implementation and set the tone of management concern for a strong system to secure assets and resources. All system access requests should be properly authorized and documented. This information should be maintained in manner that it is readily available should there be concerns regarding the provision of access rights.

**Recommendation**

We recommend that the KYTC OIT ensure that only properly authorized system access is granted to users. The required forms should be completed in a consistent manner for all users. All authorizing information is to be present on the request form prior to granting access to SiteManager and those forms should be maintained to support proper authorization for the system access granted.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-TC1-41: The Kentucky Transportation Cabinet Should Ensure That Logical Security Procedures Are Consistently Applied For The Trns\*port SiteManager System (Continued)**

---

**Management's Response and Corrective Action Plan**

*KYTC agrees that sufficient request and authorization documents must be in place and utilized as appropriate to ensure adequate logical security and an adequate audit trail.*

*KYTC OIT did not, however, maintain the referenced KYTC SiteManager ID Request form during FY06. This form was utilized by the Site Manager Application Administrator within the Division of Construction. The Site Manager application utilizes a two-tier security model in which overall database and executable access is administered by OIT while the Site Manager Application Administrator grants access within the Site Manager application. The OIT utilizes the constraints of its Request Log process to provide logical security and an audit trail while the Application Administrator uses the KYTC SiteManager ID Request form to track application access. These forms are not received or handled by OIT and this process was developed and maintained within the business area.*

*The consolidation of OIT infrastructure support responsibilities within the COT infrastructure support as well as the KYTC OIT reorganization which occurred July 15, 2006 will change this process significantly for the future. Moving forward, the KYTC OIT will continue to receive requests for SiteManager database and executable access via authorized requestors to the Request Log. OIT, however, will not grant this access; OIT will approve/disapprove requests and forward a request to COT to actually carry out the access request. Additionally, the reorganization of KYTC OIT resulted in the transfer of the current Application Administrator to OIT and the future location of these duties has not been determined as OIT is still in a transition phase.*

**Auditor's Reply**

In light of the recent Office of Information Technology (OIT) organizational restructure, and hence going forth, we still recommend that required SiteManager ID Request forms be completed in a consistent and complete manner for all users. Based upon the additional information provided in the management response above, it appears that OIT does not consider the SiteManager application security to be their responsibility. Note that the Request Log process does not provide adequate information to document the access to be provided to the SiteManager

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-TC1-41: The Kentucky Transportation Cabinet Should Ensure That Logical Security Procedures Are Consistently Applied For The Trns\*port SiteManager System (Continued)**

---

**Auditor's Reply (Continued)**

application and therefore we did not use that as the authorizing documentation for this application. We hold that the SiteManager ID Request form should be accepted as an official form to be incorporated in the overall logical security policies and procedures of the cabinet for access to this application. All authorizing information required on the form should be complete and accurate before granting access to the system, and the completed forms should be maintained to support proper authorization. Each current user and future user provided access to this system should be verified and assured of proper documentation supporting proper authorization for access. Further, procedures should be established to re-verify the access requirements to this application on a periodic basis. All of these procedures need to be incorporated into the formal security policies established by KYTC.

Regardless of the level of system decentralization and related security procedures, responsibilities for security administration, controls, and related formal policies, reside with the central level oversight authority. In this case that should be a responsibility the Chief Information Officer within OIT. If certain information technology (IT) duties are migrated to the Finance Cabinet's Commonwealth Office of Technology (COT) during reorganizations, this level of security responsibility will not change as the overall oversight responsibilities will still remain with KYTC management. KYTC management would still be responsible for ensuring adequate security policies and procedures are established and followed. Though procedures and form maintenance may be delegated to other areas, the overall responsibility remains at the central management level. If, due to redistribution of IT duties, COT policies/procedures are incorporated into KYTC processes then KYTC management still has the responsibility to ensure those COT processes do not introduce segregation of duty or other security control weaknesses over KYTC applications.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-TC2-42: The Kentucky Transportation Cabinet Should Strengthen Internal Controls On Timecards And Implement Proper Segregation Of Duties**

---

State Agency: Transportation Cabinet

During payroll testing at Kentucky Transportation Cabinet, we examined a sample of 38 payroll records. The results of our testing included the following exceptions:

- One (1) time roster was not signed by the employee.
- Four (4) time rosters were not signed by the supervisor.

We also encountered a segregation of duties issue:

- One (1) employee signed his time roster as required. He signed as a supervisor approval for the crew. He also signed the "Prepared By" and "Authorized Signature" on the OMS Daily Labor Log for the crew. In the pay period that was reviewed, this employee was the only employee on the crew that was awarded work time on 3 separate days, and he signed approval on all 4 levels.

Failure to sign on the timecard by both of the employee and the supervisor would result in noncompliance with the Transportation Cabinets' policy regarding Time Reporting Requirements.

To verify that the employee is being paid accurately, each employee is responsible for providing accurate details of time worked and leave taken. Employees on a daily basis must record their time worked on a timesheet. Supervisors must examine the said entries and approve or disapprove by signing the timesheet. Timesheets are forwarded to timekeepers for entry into the TIPS system. Even though the employee noted above did not have access to the TIPS system to input the crews time, there is a risk that the timekeeper would not question his authority and would input whatever time he approved.

Transportation Cabinets' Policy regarding Time Reporting Requirements states, "Employees record the beginning and ending work times on the daily time roster noting any leave taken during the day and the projects worked on, up to a maximum of four, for a work day. The employee signs the roster to certify that the reported time worked is accurate and complete. The employee's supervisor reviews and certifies, by signing the roster, that the entries are accurate and complete."

Good internal controls dictate that timesheet/time rosters and supporting forms should be reviewed and signed to prevent errors in recording payroll. Good internal controls dictate proper segregation of duties reduces the likelihood that errors or irregularities will remain undetected by providing for independent reviews of the work performed.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-TC2-42: The Kentucky Transportation Cabinet Should Strengthen Internal Controls On Timecards And Implement Proper Segregation Of Duties (Continued)**

---

**Recommendation**

We recommend the following:

- Timecards should be signed by both of the employee and the supervisor
- Proper segregation of duties should be implemented.

**Management's Response and Corrective Action Plan**

*Current Division of Accounts Policy and Procedures Manual Section AC 500 states:*

*Employees record the beginning and ending work times on the daily time roster noting any leave taken during the day and the projects worked on, up to a maximum of four, for a work day. The employee signs the roster to certify that the reported time worked is accurate and complete.*

*The employee's supervisor reviews and certifies, by signing the roster, that the entries are accurate and complete.*

*The timekeeper or payroll clerk should perform a post audit of the entries on a daily roster to ensure accuracy and completeness.*

*Through a recent reorganization of KYTC, Deputy Executive Director (DED) positions were established in each district. The DEDs will be responsible for the fiscal and operational matters of the district. Recent training conducted for DEDs by the Division of Accounts alerted them to various issues associated with payroll matters. Another training session is scheduled which will be payroll specific. We will ensure DEDs are cognizant of these recommendations and the required policies and procedures of KYTC regarding timekeeping. Additionally, we are offering payroll training for all timekeepers on a district-by-district basis and will ensure that timekeepers are also fully aware of these issues.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-TC3-43: The Kentucky Transportation Cabinet Should Improve Inventory Procedures For Maintenance Materials**

---

State Agency: Transportation Cabinet

The Kentucky Transportation Cabinet (KYTC) has maintenance barns in 12 districts throughout Kentucky. These maintenance barns contain not only heavy equipment used for highway safety, but also necessary supplies and material to keep state roads passable. The amount of inventory in these maintenance barns totaled \$33,844,044.04 million for FY06. Our auditors observed district personnel conducting their inventory to determine if maintenance materials were counted correctly and to determine if inventory management procedures were adequate. KYTC Internal Auditors also observed several inventory counts as well and communicated their results to KYTC management.

We issued comments the previous two years regarding various inconsistencies in the inventory process. These included inconsistent treatment of guardrail systems; unclear responsibilities for items such as antifreeze, oil, grease, etc; and no policies and procedures in place. Some districts have shown some improvements; however, there are still some problems in some districts:

- A comparison of the actual count to quantities listed on perpetual inventory sheets from Operations Management System (OMS) revealed numerous discrepancies in quantities recorded, such as inconsistent amounts for windshield wiper fluid, pipe bands, aggregates and other inventory items. OMS is not being used effectively to track materials used or on hand.
- Procedures to count bulk material items such as aggregates and asphalt mixes were not in compliance with stockpile quantity calculation procedures outlines in the "Users Guide for Field Personnel - OMS Materials Inventory" (revised 2005). Instead of measuring items as instructed, amounts were estimated based on how many loads would fit in a dump truck or the heights/weights of the aggregate piles were guessed instead of measured.
- When confirming corrections to OMS, discrepancies were noted. After the inventory is complete the districts are required to reconcile the inventory sheets to match the actual physical inventory count. The discrepancies found were immaterial; however, a proper reconciliation was not complete. It was also noted that when confirming corrections to OMS that transactions might be deleted without a history (audit trail) of the entry or deletion.
- During the inventory count the inventory team initially started to use work/repair orders to account for missing inventory instead of using the two lists as required.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-TC3-43: The Kentucky Transportation Cabinet Should Improve Inventory Procedures For Maintenance Materials (Continued)**

---

- There were various potential inventory items that district personnel did not know exactly how to account for within OMS such as:
  - Inventory that is returned upon completion of project, both usable and non-usable (guard rail, pipe, etc.)
  - Obsolete items (including a definition of what makes an item obsolete)
  - Scrapped items

Inaccurate quantities in OMS are due to the fact that some crewmembers delivering and picking up or using materials don't always inform the timekeeper. When crewmembers do not inform the timekeeper of inventory inflow and outflows, OMS is not updated properly. This leads to shortages or overages in amounts of inventory in each district.

The KYTC "Users Guide for Field Personnel - OMS Materials Inventory" provides details for district personnel regarding the physical inventory count of maintenance. When these procedures are not followed, inconsistent or inaccurate counts could occur.

The KYTC "Users Guide for Field Personnel - OMS Materials Inventory" is not inclusive of all areas of concern in the inventory count. Several districts had the same questions on how some of the inventory should be recorded, stored, disposed, and removed from OMS. Inconsistencies or inaccurate counts could occur when procedures are not entirely documented.

The KYTC "User's Guide for Field Personnel - OMS Materials Inventory" was revised in 2005. This manual provides details for district personnel regarding inventory maintenance including material management, reconciliations, and inventory procedures.

The KYTC "User's Guide for Field Personnel - OMS Materials Inventory" states, "Standard stockpile shapes for bulk materials (rock, salt, etc.) are cone or tent". And "Once a standard shape is reached the width (diameter) and length must be measured in feet."

The KYTC "Users Guide for Field Personnel - OMS Materials Inventory" states, "Stock room removals during the inventory should be done only in emergency situations. While conducting the inventory, two lists should be maintained for items removed during the inventory. One list will be for materials removed before the item is counted. The other is for the materials removed after it has been counted.



**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-TC3-43: The Kentucky Transportation Cabinet Should Improve Inventory Procedures For Maintenance Materials (Continued)**

---

Good internal controls dictate that the inventory data of the inflow and outflow of materials be up to date. The OMS system should reflect accurate quantities of all available inventory items.

Good internal controls also dictate that proper procedures be performed in the reconciliation process between the actual inventory count to the quantities of inventory in OMS. KYTC “Users Guide for Field Personnel - OMS Materials Inventory” explains proper procedures for performing the reconciliation process and should be completed in its entirety.

**Recommendation**

We recommend:

KYTC provide additional training to the OMS timekeepers, district personnel, and the inventory teams that conduct the annual inventory.

All inventory activity be recorded in OMS as it occurs. Crewmembers should be reminded to always inform the timekeepers of inventory increases and decreases.

District personnel conduct periodic inventory counts quarterly and the results should be reconciled with OMS records. KYTC internal auditors should consider observing quarterly inventory counts in districts that have continuing excessive error rates.

District personnel double-check their reconciliation in order to make sure all corrections were made. The OMS Administrator should remove the ability to delete OMS transactions. If a correction is needed, a separate reversing transaction referencing the original incorrect transaction should be entered.

District personnel follow the procedures set out in the “Users Guide for Field Personnel - OMS Materials Inventory” for counting stockpiled bulk materials and including missing inventory.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-TC3-43: The Kentucky Transportation Cabinet Should Improve Inventory Procedures For Maintenance Materials (Continued)**

---

**Recommendation (Continued)**

Additional procedures be added to the “Users Guide for Field Personnel - OMS Materials Inventory” to clarify how the following items should be recorded, store, disposed and removed in OMS:

- Inventory that is returned upon completion of project, both usable and non-usable (guard rail, pipe, etc.)
- Obsolete items (including a definition of what makes an item obsolete)
- Scrapped items

**Management’s Response and Corrective Action Plan**

*Memo below was prepared by the Transportation Cabinet*

*TO: Debra Gabbard, Executive Director  
Office of Policy and Budget*

*FROM: Marc D. Williams, Commissioner  
Department of Highways*

*DATE: January 30, 2007*

*SUBJECT: Response to Record of Control Weakness*

*In response to the attached Record of Control Weakness (RCW), the attached memorandum was issued on November 20, 2006, stating that all districts would conduct monthly inventory checks. Procedures for completing the monthly inventory reports have been generated and are being followed by all districts as of January 2007. These procedures are attached.*

*The memo requires that all districts submit the monthly reports to the Division of Maintenance on a quarterly schedule. The Division of Maintenance is developing procedures outlining what the report should contain. The Division of Maintenance will review all quarterly submittals and submit the reports the State Highway Engineer, along with any recommendations.*

*The Division of Maintenance has scheduled training on the Operations Management System (OMS) in several districts this year to assist in the transition of employees new to OMS. Additionally, the Division will work to develop procedures to address inventory returned upon completion of a project, obsolete items, and scrapped items.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-TC3-43: The Kentucky Transportation Cabinet Should Improve Inventory Procedures For Maintenance Materials (Continued)**

---

**Management's Response and Corrective Action Plan (Continued)**

*OMS is in the early stages of an upgrade to the software. As part of that upgrade we will work with the developers to eliminate the ability to delete transactions.*

***Memo below was prepared by the Transportation Cabinet***

**TO:**            *Executive Directors  
Deputy Executive Directors  
Maintenance Engineers  
Traffic Engineers*

**FROM:**       *Marc D. Williams, P.E  
Commissioner of Highways*

**DATE:**       *November 20, 2006*

**SUBJECT:**    *Material Inventories and Operations Management System*

*The accountability and management of our resources continues to be an issue of significant concern. Results of the 2006 Operational Management System (OMS) year end inventories indicate strong trends that cyclic inventories are not being conducted and efforts were made to post entries just prior to our Audit Teams reviews. The internal auditor's report for 2006 describes considerable discrepancies between OMS data and actual on-hand quantities. Error rates have declined since 2005 but we are not at the expected level.*

*The following actions are her-by directed: First, the responsibility and accountability for maintaining accurate OMS material records begins with first line leaders and supervisory personnel. Their responsibility rests clearly with the County Superintendents, Maintenance and/or Traffic Engineers and Executive Directors. Second, beginning immediately upon receipt of this memorandum, each crew's inventory will be reconciled monthly and signed by the County Superintendent and Maintenance and/or Traffic Engineer. The signed document will then be forwarded to the District Office. The Deputy Executive Director will review and consolidate the monthly reports and forward them quarterly to the Director, Division of Maintenance. The Division of Maintenance will review and*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-TC3-43: The Kentucky Transportation Cabinet Should Improve Inventory Procedures For Maintenance Materials (Continued)**

---

**Management's Response and Corrective Action Plan (Continued)**

*not any discrepancies to the State Highway Engineer. Third, the annual audit inventories will be scheduled by the Internal audits Branch in conjunction with the Auditor of Public Accounts.*

*The November 20, 2006 Memorandum titled "Material Inventories and Operations Management System" from Commissioner Williams office requires that all administrative units conduct a monthly inventory for all OMS related materials effective January 31, 2007.*

*Administrative Units will perform a one-time inventory reconciliation by January 31 in order to obtain an accurate inventory. Each month thereafter all crews will be expected to conduct an inventory count (not reconciliation) at the end of each month and forward the results to the County Superintendent and Maintenance and/or Traffic Engineer for signature and approval. The signed documents will then be forwarded to the District Office. The Deputy Executive Director will review and consolidate the monthly reports and forward them quarterly to the Director, Division of Maintenance. The Division of maintenance will review and note any discrepancies to the State Highway Engineer.*

*All material daycards on work orders and repair orders must be approved before any inventory counts are made. Open work orders will have materials assigned to them that will cause error in the inventory count.*

*A report titled "Monthly Inventory Report" has been created in the materials module under the Reports/Standard Reports drop down. This must be used for all monthly inventory counts.*

*Records should be examined to determine the cause of any discrepancies. These may include missing work orders, purchases, or transfers since the last inventory. If this is the case, the appropriate action must be taken to correct the error. Only when these remedies have been exhausted may inventory adjustments be made. Inventory adjustments must be performed by the OMS coordinator and must have written approval from the appropriate branch manager.*

*Mark all errors on the inventory sheet before correcting. Once discrepancies have been identified and corrected, make note on the inventory sheet how the error was resolved.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-TC4-44: The Kentucky Transportation Cabinet Should Implement Reconciliation Procedures To Accurately Account For Infrastructure And Provide Additional Management Oversight**

---

State Agency: Transportation Cabinet

The Kentucky Transportation Cabinet (KTC) prepares numerous spreadsheets to report infrastructure in the Comprehensive Annual Financial Report (CAFR). During our audit of infrastructure several errors were noted regarding Construction In Progress (CIP).

A comparison of KTC's FY06 "Summary of Entries to Record Infrastructure" to the FY05 "Summary of Entries to Record Infrastructure" indicated that the FY06 beginning balance for CIP did not agree to the FY05 ending balance.

We also noted where the disposals of CIP were not being capitalized as additions in an appropriate asset category in FY06. KTC did not capitalize \$7,173,221 of CIP disposals. We inquired about this and requested a reconciliation explaining the disposals and acquisition amount of the CIP. KTC could not identify or trace all the charges that were accounted for in their spreadsheet.

The FY06 "Summary of Entries to Record Infrastructure" did not include infrastructure-related buildings as had been included in previous years. KTC's FY06 entries are inconsistent with prior years. Buildings are a part of infrastructure and should be included.

KTC failed to properly monitor the CIP account. Once expenditures are capitalized as CIP, the CIP disposals should completely transfer to "additions" of another asset category upon project completion. When charges cannot be identified nor traced then there is a potential for material misstatement.

KTC Management should have developed and implemented internal controls over financial reporting to provide a reasonable assurance that the financial statements fairly represent the transactions and events that occurred in the fiscal year. GAAP requires that all infrastructure assets that are constructed or purchased which exceed the government's capitalization threshold be capitalized.

Also, good internal control and good business practices require that accounts be monitored and maintained in such a way to allow for accurate financial reporting.

COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-TC4-44: The Kentucky Transportation Cabinet Should Implement Reconciliation Procedures To Accurately Account For Infrastructure And Provide Additional Management Oversight (Continued)**

---

**Recommendation**

We recommend that KTC complete a proper reconciliation of CIP to provide greater assurance that the year-end infrastructure is accurate, complete, and fairly stated. We also recommend that KTC management provide additional monitoring of CIP and more management oversight.

**Management's Response and Corrective Action Plan**

*APA Condition*

*A comparison of KTC's FY06 "Summary of Entries to Record Infrastructure" to the FY05 "Summary of Entries to Record Infrastructure" indicated that the FY06 beginning balance for CIP did not agree to the FY05 ending balance.*

*KYTC Response*

*Beginning FY06, Construction in Progress (CIP) totals for both infrastructure and buildings did agree to FY05 Ending CIP amounts. In FY06, separate spreadsheets were prepared and submitted for CAFR reporting for CIP infrastructure and CIP buildings. This separation of reporting was consistent with the reporting practices of FY02, FY03, and FY04. The FY05 reporting practice of combining CIP of infrastructure and buildings was inconsistent to the other fiscal years due to the Auditor of Public Accounts (APA) and the Finance Cabinet's CAFR team making erroneous adjustments to KYTC's FY04 CIP beginning balance for infrastructure. Furthermore, APA and Finance failed to notify KYTC management of these adjustments. Thus, in FY05, a combined CIP for infrastructure and buildings listing was prepared so adjustments could be made to correct CAFR amounts.*

*We respectfully disagree with the APA's assertion that buildings are part of infrastructure and should be reported as such. Governmental Accounting, Auditing, and Financial Report - Using the GASB 34 Model published in 2001 by the Government Finance Officers Association certainly recognizes buildings as Capital Assets however does not include buildings in an infrastructure reporting category. Infrastructure is defined as "long-lived capital assets that normally are stationary in nature and normally can be preserved for a significantly greater*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-TC4-44: The Kentucky Transportation Cabinet Should Implement Reconciliation Procedures To Accurately Account For Infrastructure And Provide Additional Management Oversight (Continued)**

---

**Management's Response and Corrective Action Plan (Continued)**

*number of years than most capital assets. Examples of infrastructure assets include roads, bridges, tunnels, drainage systems . . ."*

*Additionally, the APA's GASB 34 training presentations posted on the APA website contain a separate workbook spreadsheet for land and buildings and another workbook spreadsheet for infrastructure to capture the value of roads.*

*It should also be noted that this segregation of buildings from other capital assets is necessary for depreciation determination. Appropriately, KTC does not report depreciation expense for its network of infrastructure subsystems (roads, bridges, highways, etc.) however, KYTC does depreciate its buildings. We recognize that both infrastructure and buildings are capital assets, but we do not treat buildings as infrastructure.*

*The KYTC tracking of capital assets is in keeping with GASB 34, the Commonwealth's CAFR presentation, and training provided by APA.*

***APA Condition***

*We also noted where the disposals of CIP were not being capitalized as additions in an appropriate asset category in FY06. KTC did not capitalize \$7,173,221 of CIP disposals. We inquired about this and requested a reconciliation explaining the disposals and acquisition amount of the CIP. KYTC could not identify not trace all the charges that were accounted for in their spreadsheet.*

***KYTC Response***

*The \$7,173,221 represents payments associated with projects which were completed and reported in previous years. Obviously there is some confusion regarding what is to be booked and reported as capital expenditures.*

*The Division of Accounts will initiate a meeting with Building and Supply to ensure all parties fully understand capital thresholds and appropriate processing of capital expenditures.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 - FINANCIAL STATEMENT FINDINGS**

**FINDING 06-TC4-44: The Kentucky Transportation Cabinet Should Implement Reconciliation Procedures To Accurately Account For Infrastructure And Provide Additional Management Oversight (Continued)**

---

**Auditor's Reply**

KTC's response indicates that the APA and FAC made adjustments to KTC's CIP calculation for infrastructure, failing to notify KTC. The APA does not and cannot directly adjust calculations or financial statements of any agency. All CAFR-related audit adjustments are presented to the FAC Reporting Team for approval. If the adjustments involve agency errors, it is FAC's responsibility to contact the agency to correct closing packages or other supporting records. In this case, audit working papers include e-mail correspondence that indicates KTC was not only notified of differences identified by the auditor in FY 2005, but prepared and sent the corrected worksheets to the APA to support adjustments made.

KTC also indicates that buildings are not included in infrastructure calculations. However, GASB 34 does allow certain buildings that are an ancillary part of infrastructure networks to be included as infrastructure (GASB 34, para 19). Due to the method KTC has reported its infrastructure-related CIP, and based on conversations with KTC management related to the CIP calculations, the APA believed KTC's calculation did include buildings. However, because we were unable to obtain satisfactory reconciliations or answers during our audit, and due to the contradictions brought up in KTC's response, this is an area that the APA will review more closely in future years to help ensure proper reporting of KTC infrastructure and other capital assets.

Finally, the APA's finding is related to CIP calculations, not to other assets. CIP is not a depreciable category for any asset type, and therefore the weaknesses noted by the APA have no impact on depreciation.



**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

*Reportable Conditions Relating to Internal Controls and/or  
Reportable Instances of Noncompliance:*

**FINDING 06-CHFS2-45: The Cabinet For Health And Family Services Should  
Implement Procedures To Ensure Services Are Received Prior To Paying The Full  
Contract Amount**

---

State Agency: Cabinet For Health And Family Services  
Federal Program: CFDA 93.778 - Medical Assistance Program  
Federal Agency: U.S. Department of Health and Human Services  
Pass-Through Agency: Not Applicable  
Compliance Area: Allowable Costs/Cost Principles  
Amount of Questioned Costs: \$1,000,000

This finding is a reportable condition for internal control over financial reporting and internal control over compliance. The entire finding can be found in the financial statement findings at 06-CHFS2-2.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-CHFS20-46: The Cabinet For Health And Family Services Should Document The Reconciliation Of Quarterly Financial Reports For The Adoption Assistance Program**

---

State Agency: Cabinet For Health And Family Services  
Federal Program: CFDA 93.659 – Adoption Assistance  
Federal Agency: U.S. Department of Health and Human Services  
Pass-Through Agency: Not Applicable  
Compliance Area: Reporting  
Amount of Questioned Costs: \$0

During the CHFS audit, we were unable to reconcile Adoption Assistance expenditures reported in the ACF-IV-E, *Foster Care and Adoption Assistance Financial Report*, for FY 06 to the MARS statewide accounting and reporting system. CHFS reported quarterly expenditures of \$7,619,334 that did not agree to total expenditures shown in MARS of \$5,493,786.16 for a difference of \$2,125,547.84. Information and explanations supporting the 4th quarter ACF-IV-E, *Foster Care and Adoption Assistance Financial Report* was not provided to the Auditor.

CHFS is not reconciling the ACF-IV-E, *Foster Care and Adoption Assistance Financial Report* with MARS. If a reconciliation was performed, CHFS did not provide the reconciliation to the Auditor.

The ACF-IV-E, *Foster Care and Adoption Assistance Financial Report* submitted to the federal government may be inaccurate. The inability to tie payments to the MARS accounting system could lead to erroneous payments for the Adoption Assistance program.

We could not determine if the report included all activity of the reporting period; was supported by applicable accounting or performance records; and, was fairly presented in accordance with program requirements.

OMB Circular A-133 - Compliance Supplement, Part 4 says, “The general ledger or other reliable records are the basis for the reports.” Good internal control dictates that the underlying accounting records are the basis for expenditures reported to the Federal government. Reliable and accurate accounting data also promotes operational efficiency. The foundation for a good internal control system begins with a minimum of reconciling amounts reported in financial reports to the accounting system.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-CHFS20-46: The Cabinet For Health And Family Services Should Document The Reconciliation Of Quarterly Financial Reports For Adoption Assistance (Continued)**

---

**Recommendation**

We recommend CHFS reconcile Adoption Assistance Program expenditures reported in the ACF-IV-E, *Foster Care and Adoption Assistance Financial Report* to the MARS accounting system and, going forward, with the new E-Mars accounting system.

**Management's Response and Corrective Action Plan**

*The \$7,619,334 is the total (state & federal) amount reported on the federal report for Maintenance only (does not include the Administration (Admin) or Training amounts for Quarter Ending (QE) 12/31/05. The \$5,493,786.16 is the amount of federal expenditures (Maintenance, Admin, & Training) that posted in MARS during QE 12/31/05. The biggest reason for the \$2,125,547.84 is that one number is total dollars for Maintenance only and the other number is federal dollars only for Maintenance, Admin, and Training. The other reason is that we can only claim Maintenance on IV-E children only and the Admin and Training claims are based on a Random Moment Time Study. So there will always be differences between what can be reported for a quarter and what actually posted during that quarter. The only time that the reports will match MARS/eMARS is after the last quarterly report is done for a Federal Fiscal Year and the final reconciling JV has been done.*

**Auditor's Reply**

We met with CHFS personnel on January 18, 2007. We acknowledge that there will be differences between the amount reported for a quarter on the report and the amount posted in MARS for the quarter. However, as we discussed during the meeting, we should still be able to reconcile the expenditures reported on the ACF IV-E *Foster Care and Adoption Assistance Financial Report* for FY 06 to MARS with the information provided to us by CHFS. CHFS should document the procedures and steps used to prepare the ACF IV-E *Foster Care and Adoption Assistance Financial Report*. We will continue to work with personnel on this issue during our upcoming audit.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-CHFS21-47: The Cabinet For Health And Family Services Should Ensure Policy And Procedures Are Adhered To And Maintain Adequate Records**

State Agency: Cabinet For Health And Family Services

Federal Program: CFDA 93.558 - TANF

Federal Agency: U.S. Department of Health and Human Services

Pass-Through Agency: Not Applicable

Compliance Area: Eligibility, Activities Allowed or Unallowed, Special Tests & Provisions

Amount of Questioned Costs: \$18,149

We reviewed 165 TANF cases (79 of the cases were tested for 60-month Lifetime Limit compliance) for eligibility from Division of Community Based Services (DCBS) offices in Breathitt, Christian, Daviess, Fayette, McCracken, and Warren counties. Local offices failed to produce records to support expenditures and follow procedures outlined in Volume III - *Kentucky Transitional Assistance Program (K-TAP)* and Volume IIIA - *Kentucky Works Program (KWP)* of CHFS' operations manual.

We noted problems in the following areas, which resulted in \$18,149 of questioned costs:

Failure to Follow Established Policies and Procedures

- One case file contained a PA-32 form processed with unused lines not crossed out in the "Description of item or service to be provided" section of the form.

Documentation or Forms Missing from Case File

- Of two kinship care files, one lacked the KC-78 and one lacked documentation of approval form P&P.

Missing Case Files

- Two case files selected for eligibility/allowable cost testing were unable to be located in their entirety.
- One case selected for special tests and provisions non-cooperation with Child Support Enforcement was unable to be located.
- Two cases selected for 60-month Lifetime Limit/Extension testing were unable to be located.

Some of these (or similar) items were commented on in the FY 01, FY 02, FY 03, FY 04, and FY 05 audits. The agency has taken steps to make caseworkers more aware of prior year findings and provide tips and reminders for processing of eligibility case files.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-CHFS21-47: The Cabinet For Health And Family Services Should Ensure Policy And Procedures Are Adhered To And Maintain Adequate Records (Continued)**

---

CHFS K-TAP and KWP policies and procedures were not adhered to by local offices and case files were not tracked and filed appropriately to prevent loss.

When K-TAP and KWP policies and procedures are not adhered to, CHFS cannot be assured that expenditures are being made appropriately and to eligible individuals. When TANF case files and records are not maintained or cannot be located, we cannot review client information and documentation for TANF eligibility. In addition, if local DCBS offices do not maintain adequate case records, the Cabinet for Health and Family Services and the U.S. Department of Health and Human Services cannot be assured that benefits are issued to eligible recipients. This could result in the DHHS assessing a penalty against CHFS. According to 45 CFR 262.1(a)(1), the penalty could be for “the amount by which a State misused its TANF funds.”

Good internal controls dictate that when caseworkers make expenditures of Federal awards, the client’s eligibility determination should be reviewed adequately and completely to ensure only eligible participants receive Federal funding. Good internal controls also dictate that program personnel be adequately trained and supervised to ensure that Federal monies are expended in accordance with program policies and procedures.

Federal Regulations at 45 CFR 205.60(a) state, “The State agency will maintain or supervise the maintenance of records necessary for the proper and efficient operation of the plan, including records regarding applications, determination of eligibility, the provision of financial assistance...The records will include information concerning the date of application, and the date and basis of its disposition; facts essential to the determination of initial and continuing eligibility (including the individual’s social security number, need for, and provision of financial assistance); and the basis for discontinuing assistance.”

Federal Regulations at 45 CFR 92.42(b)(1) also state, “...records must be retained for three years from the starting date specified in Paragraph (c)...”

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-CHFS21-47: The Cabinet For Health And Family Services Should Ensure Policy And Procedures Are Adhered To And Maintain Adequate Records (Continued)**

---

**Recommendation**

In general, we recommend K-TAP policies and procedures be adhered to before Federal funds are expended. CHFS should increase quality control reviews performed by the Quality Control branch in the Office of the Ombudsman. These reviews should be expanded to encompass compliance for all case types in the areas of K-TAP applications, recertifications, approvals, and all applicable forms pertaining to receiving payments to ensure they are made in accordance with policies and procedures. In addition, OIG should expand procedures to review case files for compliance with written policies and procedures.

The problems in the K-TAP, KWP, and WorkIncentive programs were first noted in FY 01 and continued through FY 06. Based upon evidence obtained from the cases sampled in various counties, we do not believe they are isolated to a few DCBS offices but are indicative of problems occurring statewide.

Case files should be maintained to adequately support applications, eligibility determinations, case decisions, and expenditures. CHFS should work with local offices to assist them in developing and maintaining an adequate filing system so that case files can be tracked and located. When transferring cases, the agency should develop procedures to ensure all relevant case files are transferred to the new DCBS office.

**Management's Response and Corrective Action Plan**

*The Family Self-Sufficiency (FSSB) agrees with the recommendation to expand the quality control Branch in the Office of the Ombudsman and is currently in discussions regarding expansion of the QC reviews performed by the Quality Control Branch. OIG continues to expand the Determining Eligibility Through Extensive Research (DETER) program. The DETER program assists DFS staff by conducting field investigations to ensure accuracy of information or a situation that appears suspect with respect to eligibility requirements. The FSSB has taken steps based on findings from previous years and believes that improvement has occurred based on these steps. FSSB will provide quarterly reminders to the field in the form of tips on the KAMES system regarding completion and processing of forms PA-32. FSSB will provide quarterly reminders to the field regarding the importance of completing and maintaining appropriate forms and*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-CHFS21-47: The Cabinet For Health And Family Services Should Ensure Policy And Procedures Are Adhered To And Maintain Adequate Records (Continued)**

---

**Management's Response and Corrective Action Plan (Continued)**

*documentation in all case records and specifically for Kinship Care case records. These reminders will be in the form of tips on the KAMES system. FSSB will provide quarterly reminders to the field in the form of tips on the KAMES system regarding the importance of maintenance and filing of hardcopy case records. Additionally, FSSB will issue a semi annual reminder in the form of a Family Support Memo (FSM) regarding case record maintenance and filing.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-CHFS22-48: The Cabinet For Health And Family Services Should Maintain Proper Supporting Documentation For Case Files**

---

State Agency: Cabinet For Health And Family Services

Federal Program: CFDA 93.563 – Child Support Enforcement

Federal Agency: U.S. Department of Health and Human Services

Pass-Through Agency: Not Applicable

Compliance Area: Special Tests and Provisions (Establishment of Paternity and Support Obligations, Enforcement of Support Obligations, Securing and Enforcing Medical Support Obligations, and Provision of Child Support Services for Interstate Cases)

Amount of Questioned Costs: \$0

During audit testing for the Child Support Enforcement Grant, we selected 104 child support cases to be reviewed at the child support offices located in the following counties: Clark, Fayette, Jefferson, Meade, Mercer, and Warren. Out of 104 cases tested, 73 (70.19%) were in compliance for FY 06. We noted 17 cases (16.35%) with multiple exceptions. The exceptions are as follows:

- In nine (9) instances (8.65%), the case file was missing at the time of testing. Jefferson County had seven (7) missing files; Meade County had one (1) missing file; and Mercer County had one (1) missing file.
- In three (3) cases (2.88%), support orders were not established within the required time frames.
- In four (4) cases (3.85%), the county attorney or their staff was not enforcing support orders.
- In eighteen (18) cases (17.31%), medical support was not being pursued and/or enforced. Case file/KASES documentation did not show an attempt to obtain medical insurance nor that National Medical Support Notices (CS-72's) were sent.

CHFS is required to conduct self-reviews for the Child Support program. During audit testing, we selected 33 cases subject to a federal self-assessment review. Of the 33 cases selected, the auditor was not provided supporting documentation pertaining to the federal self-assessment reviews for seven (7) cases. Since the auditor was not provided documentation for 7 of the 33 cases selected, it cannot be determined if the state is in compliance with federal requirements regarding the provision of child support services.

Failure to establish and enforce child and medical support in a timely manner hinders the state from providing the proper service to families who need the financial support.



**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-CHFS22-48: The Cabinet For Health And Family Services Should Maintain Proper Supporting Documentation For Case Files (Continued)**

---

This may cause them to remain dependent on the state for financial support, which may cost Kentucky's TANF and Medicaid programs millions of unnecessary dollars.

The purpose of the annual Federal self-assessment is to allow a state the opportunity to assess whether or not it is in compliance with federal requirements regarding the provision of child support services. Failing to identify deficiencies during the self-assessment may not ensure the contracting official is following the child support regulations.

Per 45 CFR Section 303 IV-D agencies are required to secure support for children from legally liable persons within ninety (90) days of locating the noncustodial parent. This involves the establishment of a legal order requiring the noncustodial parent to provide financial and medical insurance support to a dependent child. Unsuccessful attempts to serve process must be documented. The statute also requires the case record to be supplemented with all information and documents pertaining to the case, as well as all relevant facts, dates, actions taken, contacts made, and results in a case.

45 CFR 308.1 requires the field staff of the Division of Child Support Enforcement to conduct self-assessment reviews.

**Recommendation**

We recommend CHFS provide additional training to its contracting officials to ensure all regulations and procedures are followed and required timeframes are met. The contracting officials should take appropriate action to enforce support and medical obligations in a timely manner. In instances where health insurance is ordered, the contracting official should verify insurance information of the non-custodial parent and promptly forward the insurance information to the Medicaid agency in cases where the child is a recipient of Medicaid.

Caseworkers should accurately and thoroughly document all actions in KASES. If actions are correctly documented in KASES, this will enable caseworkers to provide efficient service to recipients of child support.

CHFS should ensure the required Federal Self-Assessments are being completed in a timely manner and results are being forwarded to the appropriate personnel.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-CHFS22-48: The Cabinet For Health And Family Services Should Maintain Proper Supporting Documentation For Case Files (Continued)**

---

**Management's Response and Corrective Action Plan**

*Missing case records- With automated interfaces with KAMES and TWIST, it is very possible a hardcopy file will not exist. Per 45 CFR 302.15, the only defined requirement that indicates it must be in the form of a hard copy file is the NPA application. All other records may be in an electronic format or the records are not directly related to a specific case. If a referral is received through an electronic interface with KAMES or TWIST and no action has been taken, a hard copy file is not likely to exist. Since we did not receive the error records, we can't determine if we agree with the finding or the recommendation.*

*Support orders established- According to the findings, 2.88% of the cases were deficient, which would indicate a compliance rate of 97.12%. The only defined bench mark for order establishment is in 45 CFR 308.2 (b), and the bench mark is 75%.*

*Enforcing support orders- According to the findings, 3.85% of the cases were deficient, which would indicate a compliance rate of 96.15%. The only defined bench mark for order establishment is in 45 CFR 308.2 (c), and the bench mark is 75%.*

*Medical support- Again, with a 17.31% deficiency rate, the indication is a compliance rate of 82.69%, and the only defined bench mark for medical support is in 45 CFR 308.2 (e). The bench mark is 75%.*

*Self Assessment- We provided either the self assessment review tool or the self assessment results worksheets for all cases that our staff reviewed. Both of these documents show the results of the self assessment review: i.e. which categories applied to the case, whether the case was found in compliance and if out of compliance, why the case was out of compliance. If a sample case is thrown out, the worker selects another case from an additional pool of cases to review. The caseworkers have not been instructed to complete a self-assessment review sheets on a case that is not reviewed. Examples of why a case would be the sample case is thrown out is that the sample case is a duplicate case, the case should have been closed, no action was required during the review period, case as an inappropriate referral from KAMES/TWIST.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-CHFS23-49: The Cabinet For Health And Family Services Should Ensure The Jefferson County Child Support Enforcement Office Has Appropriate Approvals For Computer Equipment Purchases**

---

State Agency: Cabinet For Health And Family Services  
Federal Program: CFDA 93.563 - Child Support Enforcement  
Federal Agency: U.S. Department of Health and Human Services  
Pass-Through Agency: Not Applicable  
Compliance Area: Allowable Costs  
Amount of Questioned Costs: \$49,604

CHFS contracts with county attorneys, pursuant to KRS 205.712 (6), to administer the Child Support Enforcement (CSE) program. During our audit, we noted two questionable capital project expenditures to purchase equipment. These two expenditures (\$29,447 and \$20,157) totaling \$49,604 did not have prior authorization or sufficient documentation on file. The expenditures were on the January FY06 Invoice for Jefferson County attorney's contract.

The approvals were not documented in the CHFS- CSE files for the Jefferson County Attorney or in the Jefferson County Attorney invoice files.

The lack of prior authorization and supporting documentation for the charges resulted in questionable expenditures.

The lack of proper supporting documentation and prior authorization for capital project expenditures resulted in unallowable purchases charged to the CSE program, which makes the expenditures in violation of contract provisions. Without supporting documentation we have no way to determine if the expenditures were allowable expenditures for the program.

All Purchases over \$5,000 are required to have prior authorization per OMB Circular 87, attachment B (15) (b) (2): "Capital Expenditures for special purpose equipment are allowable as direct costs, provided that items with a unit cost of \$5,000 or more have the prior approval of the awarding agency." Both the Division of Contract Development Director and Executive Director of the Office of Contract Oversight should approve these expenditures.

Prior authorization and approval procedures must be effective to ensure state and federal funds are not used in violation of the applicable rules and regulations set forth in the master agreement. The master agreement states, "The Second Party shall obtain prior written approval from the Cabinet for necessary program equipment, purchased or leased in accordance with Child Support policies and procedures."

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-CHFS23-49: The Cabinet For Health And Family Services Should Ensure The Jefferson County Child Support Enforcement Office Has Appropriate Approvals For Computer Equipment Purchases (Continued)**

---

Without supporting documentation we cannot determine if the expense is allowable.

**Recommendation**

We recommend CHFS keep adequate documentation for capital project expenditures on file, and we recommend CHFS ensure all county attorneys obtain prior approval for amounts over the capital projects threshold.

**Management's Response and Corrective Action Plan**

*CHFS' Office of Contract Oversight (OCO), Division of Contract Development Services (DCDS) has reviewed the two expenditures in question (\$29,447.75 and \$20,157.00). These expenditures were not capital project expenditures as noted within the record of non-compliance.*

*The first expenditure of \$29,447 covers four individual invoices that were billed to the Jefferson County Child Support office by Certified Systems. (1) Invoice #2005-1215 for \$15,404 was a software license renewal covering the 2/1/06 through 1-31-07 time period. (2) Invoice #2005-1216 for \$5,555 was an annual license and software maintenance renewal through the 12/31/2006 time period. (3) Invoice#2006-0110 for \$1,000 was a monthly system support agreement fee for the February 1 -28, 2006 time frame. (4) Invoice #2006-0103 for \$7,488 was a billing for hourly system support services including installation and upgrades to the KASES Linking System.*

*The second expenditure of \$20,157 covers two individual invoices that were billed to the Jefferson County Child Support office by Certified Systems. (1) Invoice #2005-1210 for \$1,000.00 was a monthly system support agreement fee for January 1-31,2006. (2) Invoice #2006-0103 for \$19,157 was a billing for hourly system support work that had been performed and the balance due on a Web Case Audit Program.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-CHFS23-49: The Cabinet For Health And Family Services Should Ensure The Jefferson County Child Support Enforcement Office Has Appropriate Approvals For Computer Equipment Purchases (Continued)**

---

**Management's Response and Corrective Action Plan (Continued)**

*Both of these expenditures were inaccurately assigned an "E" code on the expenditure report that was submitted by the Jefferson County Attorney Office for January 2006 and also reported incorrectly on the "Equipment" line on the Invoice for Title IV-D Contract form. The actual invoices in question were for various technology licensing agreements and technology services rather than capital project expenditures. The current child support procedure for equipment purchases for each County Attorney Child Support Office requires that any equipment purchase with a single-item cost of \$499 or less does not require prior Cabinet approval while any equipment purchase exceeding a single-item cost of \$500 or more requires prior approval by the Cabinet. Requirements regarding equipment purchases are also outlined in Section 9 of all the County Attorney Office contracts. Pursuant to internal OCO equipment approval procedures when an equipment approval request is received by a Contract Specialist it is reviewed and approved by the DCDS Director. If the request exceeds \$5,000.00 then an additional approval is also required by the OCO Executive Director. In this instance the proper approval procedures were not followed by the Contract Specialist who administered the Jefferson County Attorney contract since the prior approval for all technology related purchases for services/equipment was not obtained. The current procedure requires that the contract specialist obtain prior approval from the CHFS Office of Information Technology for all technology related purchases including services and licensing agreements. Additionally, the audit finding noted that the required supporting invoice information was not maintained by the Jefferson County Attorney's Office. Pursuant to the County Attorney Child Support contract all supporting documentation is required to be maintained in each individual County Attorney Office.*

*Corrective Action Plan:*

*(1) A Memorandum from the Office of Contract Oversight will be issued to the Director of Child Support Enforcement for dissemination statewide to all of the Child Support Contracting Officials. This memo will contain a reminder of the required equipment request procedures and the proper billing steps to ensure future compliance.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-CHFS23-49: The Cabinet For Health And Family Services Should Ensure The Jefferson County Child Support Enforcement Office Has Appropriate Approvals For Computer Equipment Purchases (Continued)**

---

**Management's Response and Corrective Action Plan (Continued)**

*(2) A Memorandum from the Office of Contract Oversight will be issued to the Jefferson County Attorney Office reminding them of their obligation to maintain all supporting invoice documentation including any prior approvals that were received in conjunction with equipment and/or technology related purchases.*

*(3) The equipment approval procedure will be revised within the Office of Contract Oversight to require the contract specialist to match up any prior authorization documentation to equipment/technology invoices prior to submitting the actual monthly reimbursement request for payment. The contract specialist will attach the equipment purchase approval documentation form to the invoice and assure it is included with the specific month the expenditure is reimbursed. This is to ensure that the contract specialist who administers these contracts will verify that prior authorizations for all applicable equipment/technology purchases have been obtained PRIOR to the expenditure reimbursement being processed for payment.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-CHFS24-50: The Cabinet For Health And Family Services Should Ensure Financial Records For Administration Of The Child Support Enforcement Program Remain On-Site At The Meade County Attorneys Office At All Times**

---

State Agency: Cabinet For Health And Family Services  
Federal Program: CFDA 93.563 - Child Support Enforcement  
Federal Agency: U.S. Department of Health and Human Services  
Pass-Through Agency: Not Applicable  
Compliance Area: Allowable Costs  
Amount of Questioned Costs: \$178,511

CHFS contracts with county attorneys, pursuant to KRS 205.712 (6), to administer the Child Support Enforcement (CSE) program. We attempted to audit the CSE expenditures that were submitted for reimbursement by the Meade County Attorney's office. However, all CSE financial records related to program administration, such as timesheets, bank account records, invoices, purchase orders were not available at the Meade County Attorney's Office at the time of the audit. Therefore, we could not verify the propriety of the \$178,511 in Federal fund expenditures that were paid to the Meade County Attorney for administering the Child Support Enforcement program.

We could not determine if expenditures that were reimbursed under the contract were in compliance with federal and state laws and regulations. We could not determine if Meade County CSE costs were allowable expenditures under the contract, or if they were recorded properly.

Financial records must be available, on-site at the subrecipient location, in order to determine if contracts are being administered in accordance with state and federal laws and regulations. No assurance can be provided that the Meade County Attorney's office used Federal funds for allowable contract activities that were necessary and reasonable for program administration; nor can any assurance be provided that invoiced amounts were calculated, recorded, and reported correctly.

The Master Agreement CSE has with the Meade County Attorney states at section 6.1, "The Second Party shall establish and continue to maintain an accounting system in a manner which provides a clear distinct audit trail, as defined by Section 7.2, for the purpose of accounting and auditing the receipt and expenditure of all public funds received through this contract."

It further states, at section 7.2, "The Second Party shall determine allowable costs on the basis of generally accepted methods of cost accounting allowable cost as

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-CHFS24-50: The Cabinet For Health And Family Services Should Ensure Financial Records For Administration Of The Child Support Enforcement Program Remain On-Site At The Meade County Attorneys Office At All Times (Continued)**

---

determined in OMB Circular A-122 or A-87, as applicable, and maintain financial records, documents, reports, and other evidence which properly reflect all direct or indirect costs of any nature expended in the performance of this agreement, and maintain statistical data and reports as required by the IV-D Agency or the federal government.”

**Recommendation**

We recommend all financial documentation for the administration of the CSE program should remain on-site at the Meade County Attorney’s office at all times.

**Management’s Response and Corrective Action Plan**

*DCS personnel met with APA auditors on January 16, 2007, for the entrance meeting to discuss the scope of the FY06 compliance work. At that time, the Division was made aware of possible issues relating to the Meade County Child Support program. The incoming County Attorney, had not notified the Division of any problems. After the meeting, a CHFS employee contacted the in-coming County Attorney to determine the specific issues. The only issue reported was that the former County Attorney, had failed to turn over any financial or personnel records. On February 5, 2007, the Deputy Commissioner, sent a letter to the former County Attorney requesting that he turn over these records within 5 days. On February 28, 2007, the Division received a letter from former the County Attorney advising that he turned over the personnel files on February 19, 2007, but could not turn over the financial records until had he received a final audit, pursuant to KRS 64.830. This statute does not specifically apply to the child support program and it is not referenced in the child support contract but this is the statute that the outgoing county attorney is relying on to support his failure to turn over the financial records. The child support contract does not contain specific procedures that an incoming or outgoing county attorney must follow. In a meeting with KCAA representatives in January we did discuss adding this language to the contract but decided that because it would be another 4 years before we had to deal with mass changes again, we could work on the changes, with the expectation that the changes would be placed in the SFY 09 contract.*



**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-CHFS24-50: The Cabinet For Health And Family Services Should Ensure Financial Records For Administration Of The Child Support Enforcement Program Remain On-Site At The Meade County Attorneys Office At All Times (Continued)**

---

**Management's Response and Corrective Action Plan (Continued)**

*A letter will be sent to the former County Attorney from the Deputy Commissioner pending review. Once the letter has been sent, the Division will follow up with that office to insure that these records are transferred.*

*The Division's Policy Section will also work with the Office of Contract Oversight to develop written procedures for incoming and outgoing Contracting Officials to follow with the expectation that these will be issued as a Policy document and placed in the Contracting Official's contract for SFY 09.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-COMM1-51: The Commerce Cabinet Should Ensure The New West Branding Contract's Billing Procedures Are Improved**

---

State Agency: Commerce Cabinet  
Federal Program: Multiple - See Table Below  
Federal Agency: Multiple - See Table Below  
Pass-Through Agency: Not Applicable  
Compliance Area: Allowable Costs  
Amount of Questioned Costs: \$33,971

On July 10, 2006, the Kentucky Office of the Attorney General (KYOAG) formally requested an audit of the New West Branding Contract administered by the Kentucky Commerce Cabinet. Under the provisions of this contract, New West had developed the "Unbridled Spirit" advertising campaign for the Commonwealth of Kentucky in addition to providing normal advertising services for the Commonwealth. The Attorney General expressed several areas of concern in his audit request including one concerning the potential misuse of federal grants and the manner in which the Commerce Cabinet accounted for and charged participating agencies in New West's fees. The Attorney General specifically requested that the Auditor of Public Accounts, as well as the Finance and Administration Cabinet work together to conduct a thorough audit. We responded to the Attorney General request on July 20, 2006 and stated that we would wait and review the findings and analysis of the Finance and Administration Cabinet before determining what, if any, further action on our part would be appropriate. This comment is the result of those actions.

In response to the Attorney General's request, the Office of Policy and Audit in the Finance and Administration Cabinet performed a review of the New West Branding Contract (audit report). A Report to the Secretary was issued on November 9, 2006. On that same day, the Secretary issued a written decision that was final and conclusive in accordance with KRS 45A.235. In that determination, several findings were made, but the determination related to the potential misuse of federal grants stated that the:

"Commerce Cabinet, in conjunction with the FAC Office of the Controller, should use information in Table 14 and Table 15 of the audit report as a base from which to calculate the monetary benefit from the 10% cap that each participating agency should have received when the excess payments were used toward the branding initiative. Agencies should then be reimbursed for the excess amounts they paid, with particular attention being paid to the federal portion. From this point forward, monetary benefits from the 10% cap should be passed along to participating agencies."

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-COMM1-51: The Commerce Cabinet Should Ensure The New West  
Branding Contract's Billing Procedures Are Improved (Continued)**

---

As stated in the audit report, the Kentucky Department of Tourism advanced the total amount for the branding initiative that cost \$648,027. A monthly retainer of \$125,000 was paid to New West for the year ended June 30, 2005. A monthly retainer of \$125,000 for the first six months and \$100,000 for the last six months was paid to New West for the year ended June 30, 2006. New West voluntarily reduced the amount of the retainer for the last half of that year. Thus, the total retainer paid for the year ended June 30, 2005 was \$1,500,000 and the total retainer paid for the year ended June 30, 2006 was \$1,350,000. The total retainer for both years was therefore \$2,850,000.

The total amount billed to the various participating state agencies was \$1,827,563 (against which the \$1,500,000 retainer fee was applied) for the year ended June 30, 2005 and \$1,633,906 (against which the \$1,350,000 retainer fee was applied) for the year ended June 30, 2006. Therefore \$327,563 was over billed for the year ended June 30, 2005 and \$283,906 was over billed for the year ended June 30, 2006. The total amount over billed for both years combined was \$611,469. Thus, Commerce used this amount to partially offset the branding initiative cost of \$648,027.

Through work performed by the Office of Policy and Audit, they estimated that \$75,132 of the \$611,469 was paid from federal dollars by seven state agencies. This \$75,132 amount was computed as follows. First, they calculated the total billings (\$1,827,563 and \$1,633,906) of New West by agency for each fiscal year. Then each agency's New West billings were divided by the total New West billings for each fiscal year. This percentage was then applied against the total excess billing for each year to come up with each agency's estimated share of the total excess billing. Those state agencies, which used federal funds to pay for this excess billing, are listed here in a Schedule of Questioned Costs.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-COMM1-51: The Commerce Cabinet Should Ensure The New West  
Branding Contract's Billing Procedures Are Improved (Continued)**

<b>SCHEDULE OF QUESTIONED COSTS</b>						
<b>Agency</b>	<b>Agency No.</b>	<b>Affected CFDA #s</b>	<b>Master Agreement</b>	<b>Estimated Share FY 05</b>	<b>Estimated Share FY 06</b>	<b>Total</b>
Education Cabinet	540, 540B	10.559, 10.560, 84.040	M-04627950	\$ 1,800 1,311	\$ 478 677	\$ 2,278 1,988
Division of Military Affairs	095	97.040	M-04656528	6,475	3,854	10,329
Kentucky Office of Homeland Security	GOV	97.004, 97.067	M-05023137	1,545	623	2,168
Cabinet for Health and Family Services	728, 721, 730, 736	93.268, 93.283, 93.779, 93.568, 93.556	M-04563733	4,947	2,319	7,266
Department of Agriculture	035	10.025, 10.156	M-04547657	8,345	1,973	10,318
Justice & Public Safety Cabinet (KY State Police)	520	20.600	M-04704224	16,661	3,944	40,605
Department for Workforce Investment	531	81.126, 84.346	M-04586647	77	103	180
<b>Total Questioned Costs</b>				<b><u>\$ 41,161</u></b>	<b><u>\$ 33,971</u></b>	<b><u>\$ 75,132</u></b>

Since the current audit period for the Statewide Single Audit is for the year ended June 30, 2006, we are currently questioning only the \$33,971 relating to that audit period. It must be noted, however, that \$41,161 would also have been a questioned cost for the Statewide Single Audit for the year ended June 30, 2005.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-COMM1-51: The Commerce Cabinet Should Ensure The New West Branding Contract's Billing Procedures Are Improved (Continued)**

For a complete description of the affected CFDA #s described above, please refer to the chart below.

CFDA DESCRIPTIONS			
CFDA#	FEDERAL DEPARTMENT	FEDERAL AGENCY	PROGRAM
10.025	Department of Agriculture	Animal & Plant Health Inspection Service	Plant and Animal Disease, Pest Control, and Animal Care
10.156	Department of Agriculture	Agricultural Marketing Service	Federal-State Marketing Improvement Program
10.559	Department of Agriculture	Food & Nutrition Services	Summer Food Service Program for Children
10.560	Department of Agriculture	Food & Nutrition Services	State Administrative Expenses for Child Nutrition
20.600	Department of Transportation	National Highway Traffic Safety Administration	State and Community Highway Safety
84.010	Department of Education	Office of Elementary and Secondary Education	Title I Grants to Local Educational Agencies
84.126	Department of Education	Office of Special Education and Rehabilitative Services	Rehabilitation Services - Vocational Rehabilitation Grants to States
84.346	Department of Education	Office of Vocational and Adult Education	Vocational Education - Occupational and Employment Information State Grants
97.004	Department of Homeland Security	NA	State Domestic Preparedness Equipment Support Program
97.040	Department of Homeland Security	NA	Chemical Stockpile Emergency Preparedness Program
97.067	Department of Homeland Security	NA	Homeland Security Grant Program

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-COMM1-51: The Commerce Cabinet Should Ensure The New West Branding Contract's Billing Procedures Are Improved (Continued)**

CFDA DESCRIPTIONS			
CFDA#	FEDERAL DEPARTMENT	FEDERAL AGENCY	PROGRAM
93.268	Department of Health & Human Services	Centers for Disease Control	Immunization Grants
93.283	Department of Health & Human Services	Centers for Disease Control	Centers for Disease Control and Prevention - Investigations and Technical Assistance
93.568	Department of Health & Human Services	Administration for Families and Children	Low-Income Home Energy Assistance
93.556	Department of Health & Human Services	Administration for Families and Children	Promoting Safe and Stable Families
93.779	Department of Health & Human Services	Centers for Medicare and Medicaid Services	Centers for Medicare and Medicaid Services Research, Demonstrations and Evaluations

As part of their work the Office of Policy and Audit also determined that over two fiscal years (FYE 6/30/05 and FYE 6/30/06) \$3,913,454 in federal funds were used to pay for various advertising services under the New West contract. They determined that benefits from the 10% cap calculation were not passed along to agencies using these federal funds contrary to federal requirements, as we have previously described.

This happened because the Kentucky Commerce Cabinet initially determined that state agencies would ultimately benefit from branding in the future and thus should share in the front-end cost of the branding initiative. Apparently, the fact that excess fee payments received from New West to the Commerce Cabinet were not to be paid back to the agencies until reconciliations were performed at the end of the contract period was not effectively communicated back to these agencies. Therefore, payments made by these agencies using federal dollars were not appropriately accounted for and has to be questioned at this time.

OMB Circular A-87 (Attachment A, Section C, Subsection 4(c) requires that any type of discount received by the federal grantee should be passed onto agencies paying with federal funds.

COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-COMM1-51: The Commerce Cabinet Should Ensure The New West  
Branding Contract's Billing Procedures Are Improved (Continued)**

---

**Recommendation**

We recommend that each affected state agency review the payments made for the New West contract and properly determine those moneys that were paid with federal program dollars based on the charts above and, if necessary, with the FAC audit report discussed above. Those amounts, based on the charts above, should be repaid to the affected federal programs as necessary. It was not practical for us go into each agency and track each billing over the two year period to accurately determine the exact amount chargeable to each of the affected CFDA #s. There may be other issues involved such as the timing of when the payments were made and when the 10% cap may have been reached. Hence, we believe the most prudent solution is for each agency to determine that part of the excess-billed amount paid to New West that was paid with federal funds. Then each agency should repay that amount to each respective federal grant. In the process of determining the amount to be repaid to the federal grant, each agency will also be computing the amount that it should receive from the Commerce Cabinet as its share of the excess-billed amount.

We further recommend that the Kentucky Commerce Cabinet work with the affected state agencies to reimburse those agencies that amount which was over billed incorrectly so that those state agencies can be made whole. This has already been agreed to in the Cabinet's response to the Secretary of Finance in November 2006.

We also recommend that all state agencies, particularly a lead agency such as the Commerce Cabinet, establish procedures to ensure that when such over billing occurs in the future and discounts are received from payments that have been made from federal funds that appropriate credit is rebated back to the over billed state agency. This could be from future advertising contracts or any similar type contract arrangements.

**Management's Response and Corrective Action Plan**

*Commerce Cabinet*

*The Commerce Cabinet is currently working with the Finance and Administration Cabinet and representatives from each affected agency to determine the amount of refund to which those agencies may be entitled. Any overpayments will be reimbursed to the affected agencies.*

COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-COMM1-51: The Commerce Cabinet Should Ensure The New West  
Branding Contract's Billing Procedures Are Improved (Continued)**

---

**Management's Response and Corrective Action Plan (Continued)**

*Cabinet for Health and Family Services*

*The Cabinet for Health and Family Services will review all payments made for the New West contract and will properly determine all overpayments. We will request reimbursement from the Commerce Cabinet for all overpayments as well as repay each federal grant affected*

*Education Cabinet*

*The Education Cabinet has reviewed the invoices paid in FY 05 and 06 and has determined they were properly paid for services rendered under the scope of the New West contract. However, while the Education Cabinet properly made such payments to the Commerce Cabinet for services rendered under the contract, it is our understanding from the APA comment that we should have received an appropriate credit for our payments above the retainer amount. We plan on working with our sister agencies to review and correct all oversights.*

*Department of State Police*

*In response to an inquiry received by the Department of State Police regarding the SSWAK, specifically the issue of the New West contract. The audit indicated the Department of State Police overpaid the Commerce Cabinet \$16,661 during FY 2005 and \$23,944 during FY 2006. The entire portion of which was paid with federal dollars.*

*We have established a contact with both the Department of Tourism and the Finance Cabinet regarding this overpayment and are currently working with both state agencies to ensure our account is credited for the overpayment, or the monies are reimbursed to the department.*



**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-DFWR1-52: The Department Of Fish And Wildlife Resources Should Develop Policies And Procedures Over All Job Duties, Retention Of Accounting Records, And Timely Vendor Payments**

---

State Agency: Commerce Cabinet - Department of Fish & Wildlife Resources

Federal Program: CFDA 15.605 - Sport Fish Restoration

CFDA 15.611 - Wildlife Restoration

Federal Agency: U.S. Department of the Interior

Pass-Through Agency: Not Applicable

Compliance: Activities Allowed / Allowable Costs

Amounts of Questioned Costs: \$670

During our testing of internal controls and compliance requirements over allowable costs and activities, we determined that the Department of Fish and Wildlife Resources (KDFWR) made four (4) duplicate payments to four different vendors during FY 2006. In two of the instances, the vendors were paid a duplicate payment as a result of them having submitted an additional copy of an originally paid invoice. Another duplicate payment resulted from paying a vendor from the vendor's facsimile copy of a previously submitted and paid invoice. The other duplicate vendor payment occurred as a result of the vendor submitting two separate invoices, each with separate vendor names and invoice numbers.

Also during our testing, we noted that two (2) of the invoices for monthly utilities were marked past due (over 30 days past due). In addition, we were unable to perform testing of two (2) other invoices due to the failure by KDFWR to adequately maintain the supporting documentation. The agency was unable to locate any of the documentation related to the particular transactions requested.

Due to the above noted findings, we expanded our testing of internal controls and compliance over allowable costs and activities. We discovered that KDFWR had vendor invoices totaling \$150,332 that were greater than thirty (30) days past due as of June 30, 2006. Of the invoices outstanding at 6/30/06, thirty-two (32) invoices totaling \$78,731 were more than 120 days past due.

The failure by Department of Fish and Wildlife Resources to detect duplicate vendor payments is attributable to the lack of adequate internal controls over accounting functions, and consequently, internal controls over the OMB Circular A-133 compliance requirements for Allowable Costs and Allowable Activities. Of the four duplicate payments discovered, one (1) is considered a disallowed cost (\$670), as KDFWR requested and received two federal reimbursement payments for the one transaction.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-DFWR1-52: The Department Of Fish And Wildlife Resources Should Develop Policies And Procedures Over All Job Duties, Retention Of Accounting Records, And Timely Vendor Payments (Continued)**

---

The failure to adequately maintain supporting documentation for all transactions raises doubt as to the validity of the transactions, as well as limiting the ability to determine whether transactions are allowable under the appropriate federal programs.

The failure to pay outstanding vendor payments within thirty (30) working days constitutes a noncompliance with Kentucky Revised Statutes (KRS) as defined in Chapter 45 and the Commonwealth of Kentucky's Finance and Administration Cabinet's Manual of Policies and Procedures (FAP). Management's failure to verify that all vendor invoices are paid within the required thirty (30) business days is an internal control weakness over compliance with the applicable KRS and FAP. In addition, since the majority of KDFWR's invoices are for grant program expenditures, the agency is not taking advantage of the approved federal funding.

Proper internal controls require that policies and standard operating procedures for all accounting functions be clearly written and communicated to all administrative staff, as well as the necessary program staff in order to assure compliance with all OMB Circular A-133 requirements regarding Activities Allowed and Allowable Costs.

Code of Federal Regulations Title 50: Wildlife and Fisheries, §80.19 - Records, requires, "The State shall maintain current and complete financial, property and procurement records in accordance with the requirements contained in the Federal Aid Manual and OMB Circular A-102." §80.19 paragraphs (a) and (b) require the following:

- (a) Financial, supporting documents, and all other records pertinent to a project shall be retained for a period of three years after submission of the final expenditure report on the project. If any litigation, claim, or audit was started before the expiration of the three-year period, the records shall be retained until the resolution is completed. Records for nonexpendable property shall be retained for a period of three years following final disposition of the property.
- (b) The Secretary and the Comptroller General of the United States, or any of their duly authorized representatives, shall have access to any pertinent books, documents, papers and records of the State.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-DFWR1-52: The Department Of Fish And Wildlife Resources Should Develop Policies And Procedures Over All Job Duties, Retention Of Accounting Records, And Timely Vendor Payments (Continued)**

---

In addition, in accordance with the Commonwealth of Kentucky's Finance and Administration Cabinet's Manual of Policies and Procedures, Section II: Division of Statewide Accounting Services, Policy No. FAP 120-21-00 Retention of Accounting Documents:

An agency that processes accounting and payment documents shall abide by this document retention policy. An agency using the state's procurement system or accounting system, with pre-audit delegation, shall not provide original source documents to the Finance and Administration Cabinet, and shall maintain such documentation and retain the documents in the agency.

An agency shall maintain the original source document that initiated a transaction and shall maintain a system of tracking that allows for auditing the original source document back to the electronic system.

Kentucky Revised Statutes (KRS) 45.451 to 45.458 establish the guidelines for vendor invoice payments. Specifically, KRS 45.453 states that "All bills shall be paid within thirty (30) working days of receipt of goods and services or a vendor's invoice except when the purchasing agent has transmitted a rejection notice to the vendor." In addition, KRS 45.454 requires "An interest penalty of one percent (1%) of any amount approved and unpaid shall be added to the amount approved for each month or fraction thereof after the thirty (30) working days which followed receipt of the goods or services or vendor's invoice by a purchasing agent."

Likewise, the Commonwealth of Kentucky's Finance and Administration Cabinet's Manual of Policies and Procedures, Section II: Division of Statewide Accounting Services, Policy No. FAP 120-05-00 incorporates the above KRS guidelines for payments of vendor invoices.

**Recommendation**

We recommend the Department of Fish and Wildlife Resources establish written policies and standard operating procedures that clearly define administrative functions, including all accounting and payroll functions. The policies and procedures should provide clear instructions on the particular job duties and expectations as they relate to the administration of federal, state, and other financial resources. We recommend that in developing such procedures, consideration be given to OMB Circular A-133 Compliance, Part 6 - Internal

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-DFWR1-52: The Department Of Fish And Wildlife Resources Should Develop Policies And Procedures Over All Job Duties, Retention Of Accounting Records, And Timely Vendor Payments (Continued)**

---

**Recommendation (Continued)**

Control, pertaining to control objectives, risk assessment, control activities, information and communication, and monitoring. All policies and procedures should be clearly communicated to the appropriate staff and readily available for their use.

Likewise, the Department of Fish and Wildlife Resources should develop written policies and procedures related to the retention of all necessary supporting accounting records and documentation, supervisory reviews and authorizations. The policies and procedures should be communicated to the appropriate staff and readily available for their use.

Lastly, the Department of Fish and Wildlife Resources should develop written policies and standard operating procedures that incorporate the state's Kentucky Revised Statutes 45.451 to 45.458, as well as the Division of Finance and Administration Cabinet's accounting policy number FAP 120-05-00, pertaining to timely payments of vendor invoices. The policies and standard operating procedures should be communicated to the appropriate staff members and supervisors. The timing of invoice payments directly impacts the agency's ability to request federal reimbursements of program expenditures that are paid by state resources. Because the majority of expenditures incurred by the KDFWR are related to federally reimbursable funds, KDFWR should consider the need for staff training on the proper processing and payments of invoices, as well as the timing of such payments.

**Management's Response and Corrective Action Plan**

*The Kentucky Department of Fish and Wildlife Resources agrees with recommendation #1. The Division of Administrative Services has been able to increase the level of accounting, grants and payroll staff beginning with fiscal year 2007. With now having sufficient staff in place for these functions, the Administrative Services Division has been able to more appropriately and clearly allocate administrative functions. These defined responsibilities have already been communicated to staff as well as specifically incorporated into the employees' official Performance Plans for purposes of accountability. The Administrative Services division has also already instituted a weekly report for evaluating productivity and performance expectations within the*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-DFWR1-52: The Department Of Fish And Wildlife Resources Should Develop Policies And Procedures Over All Job Duties, Retention Of Accounting Records, And Timely Vendor Payments (Continued)**

---

**Management's Response and Corrective Action Plan (Continued)**

*Accounting/Grants Branch; this report is used for discussions in weekly meetings involving Division Management and the Accounting/Grants Branch. In response to this recommendation, the Division of Administrative Services will continue to enhance policies and standard operating procedures relating to the accounting, grants and payroll functions and include guidelines according to OMB Circular A-133 Compliance, Part 6 - Internal Control, pertaining to control objectives, risk assessment, control activities, information and communication, and monitoring.*

*The Kentucky Department of Fish and Wildlife Resources agrees with recommendation #2. The Department has already established policies and procedures with regards to retaining the appropriate documentation to support accounting functions, supervisory reviews and authorizations. The Department also takes advantage of the state's Records Retention Schedule pertaining to accounting and federal grant documents, and thanks to added staff (specifically a new Records Retention Officer and a permanent file clerk) during Fiscal Year 2007, we have been able to more effectively manage files, records and supporting documentation. Specifically relating to supervisory review and authorization, the department has twice issued a directive since FY 2006 requiring division director authorization on purchases costing between \$500 and \$999. This same directive requires deputy commissioner authorization on purchases equaling or greater than \$1,000.*

*In addition to this \$500 threshold, Department employees have been instructed that any purchase of specific items—optical equipment, firearms, ammunition, books, dues or subscriptions, digital cameras, power tools or GPS units—must be pre-approved regardless of the cost. Division Director shall pre-approve these listed items that cost up \$999; Deputy Commissioner shall pre-approve these items that cost \$1,000 or greater.*

*All purchase requisitions are processed and approved electronically (email) and forwarded to a centralized email server (Address: FWAccounting.gov) for reference by members of the Administrative Services Division prior to payment. In response to this finding, the Department will re-issue a policy statement to the Administrative Services Division to remind staff of their responsibility for*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-DFWR1-52: The Department Of Fish And Wildlife Resources Should Develop Policies And Procedures Over All Job Duties, Retention Of Accounting Records, And Timely Vendor Payments (Continued)**

---

**Management's Response and Corrective Action Plan (Continued)**

*checking the FWAccounting.gov repository for a completed requisition on the appropriate purchases. To further ensure this requirement is upheld, the Division of Administrative Services has already increased staff access to the FWAccounting.gov email repository, and this prerequisite to paying invoices will be added to a previously-established quality control checklist used by accounting staff. In response to this finding, the Department will re-issue a policy statement to all employees to ensure pre-approval for purchase of these specific items.*

*With regard to employee authorization, the Department of Fish and Wildlife Resources issued a policy directive in FY 2006 that requires all invoices that total less than \$500 still include the purchaser's name and signature approval along with the appropriate coding (Accounting template and E-CODE). This policy will be re-issued in a formal memo.*

*The Kentucky Department of Fish and Wildlife Resources agrees with recommendation #3. The Department of Fish and Wildlife Resources has been continuously drafting and updating policies and standard operating procedures relating to the timely payment of vendor invoices. The ability to maintain these policies has been enhanced with the added staff during Fiscal Year 2007 for both grants and accounting functions. With the implementation of EMARS, the Department revised and automated our accounts payable workflow to ensure consistent review by supervisors and grant analysts to ensure proper and timely payment. The Administrative Services Division has also enhanced the payment process by more equally dividing the workload among invoice payments, contract payments, vendor modifications, utility payments, direct bills, and inter-accounts. The Administrative Services Division also issued during this fiscal year a quality control checklist that requires the submitter and each level of approval to check the document for accuracy and compliance with department policies and guidelines. The Administrative Services division has also instituted a weekly report for evaluating productivity and performance expectations within the Accounting/Grants Branch; this report is used for discussions in weekly meetings involving Division Management and the Accounting/Grants Branch. This report and meetings weekly, along with the other directives mentioned above, will be used to continue promoting efficiency in accounts payable functions.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-DFWR1-52: The Department Of Fish And Wildlife Resources Should Develop Policies And Procedures Over All Job Duties, Retention Of Accounting Records, And Timely Vendor Payments (Continued)**

---

**Management's Response and Corrective Action Plan (Continued)**

*In response to this recommendation, the Department will continue to enhance the existing written accounting policies to incorporate the state's Kentucky Revised Statutes 45.451 to 45.458, as well as the Division of Finance and Administration Cabinet's accounting policy number FAP 120-05-00, pertaining to timely payments of vendor invoices. As with other policies and procedures referenced in this agency response, each directive on timely payment of invoices will be communicated to the appropriate staff members and supervisors.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-DFWR2-53: The Department Of Fish And Wildlife Resources Should Make Use Of All State Financial Accounting System Components For Proper Administration Of Federal And State Resources**

---

State Agency: Commerce Cabinet - Department of Fish & Wildlife Resources

Federal Program: CFDA 15.605 - Sport Fish Restoration

CFDA 15.611 - Wildlife Restoration

Federal Agency: U.S. Department of the Interior

Pass-Through Agency: Not Applicable

Compliance: Activities Allowed and Allowable Costs

Amounts of Questioned Costs: \$0

The Department of Fish and Wildlife Resources (KDFWR) does not maintain or apply its federally approved indirect cost allocation rates through use of the state's MARS Financial System. Although the indirect costs and cost adjustments are tracked through use of electronic spreadsheets, the accounting data is never input to the MARS Financial System.

Failure to compute the applicable indirect costs and cost adjustments through the states general ledger system constitutes an internal control weakness. Although the federally approved rates are applied to various grant projects through use of electronic spreadsheets, the failure to establish, apply, record, and maintain the indirect cost allocations and related adjustments in the MARS general ledger system could lead to the misapplication of approved rates. Consequently, a misapplication of indirect cost rate may lead to a federal noncompliance. In addition, the KDFWR financial reports generated by MARS are misleading due to failure to include the indirect cost data.

Proper internal controls over allowable costs and activities, dictate that all financial data be maintained in the appropriate general ledger system (i.e., MARS). Financial data includes, but is not limited to, the proper establishment of indirect cost tables, agency and federal government cost match rates, as well as other input parameters related grant program administration. In addition, proper internal controls dictate that all supporting financial data be reconciled timely to the various budget and other MARS-generated financial reports.

**Recommendation**

The Department of Fish and Wildlife Resources should obtain the necessary eMARS training (effective July 1, 2006) sufficient to establish, record, maintain, and report all pertinent grant, as well as agency, financial data for the proper administration of federal and state resources.



**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-DFWR2-53: The Department Of Fish And Wildlife Resources Should Make Use Of All State Financial Accounting System Components For Proper Administration Of Federal And State Resources (Continued)**

---

**Management's Response and Corrective Action Plan**

*Kentucky Department of Fish and Wildlife Resources agrees with this recommendation and continues to push to incorporate the agency's indirect cost allocation rates into the statewide accounting system—now EMARS. This finding was also reported for fiscal year 2005, at which time (March of 2006) the Department began working to initiate this action with the EMARS transition team.*

*As the FY 05 audit finding was not reported until March of 2006, KDFWR had only three (3) months remaining before MARS was transitioned to EMARS. This timeframe combined with the scope of changes necessary to fully integrate all agency processes in MARS prevented us from incorporating these processes in MARS. For the transitional timeframe remaining in MARS (i.e., April, May and June 2006) and in order to facilitate a successful integration of agency accounts to the eMARS system, manual reconciliations were completed for the data in MARS. Formal action taken on this finding was limited to what we were able to implement and otherwise accomplish in EMARS.*

*KDFWR contacted the Finance Cabinet in 2006 (late FY06) to express interest in using EMARS Advantage Financial, which included an Overhead Rate process that could be used for grants to calculate overhead as a fixed percentage of grants expenses and post the results as a reimbursable charge against the grant. KDFWR pursued identifying a fixed rate with this EMARS function in mind, and at the end of July 2006, this agency with the Finance Cabinet began testing. In a September 2006 email from the Finance and Administration Cabinet, KDFWR was advised that the "there are no resources available at this time" to automate our indirect cost allocation rates. KDFWR was advised instead to "use a manual approach (infoAdvantage reports and manual entry of CH documents)" to accomplish our indirect cost allocation process. This agency is utilizing CH documents and a Fixed with carry forward rate to record, maintain, and structure EMARS to correspond with our federal reports. KDFWR continues to work with the Finance and Administration Cabinet to achieve our original goal of automating our indirect cost allocation rates.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-DFWR3-54: The Department Of Fish And Wildlife Resources Should Implement Its Internal Policies And Procedures Over Vendor Invoice Payments**

---

State Agency: Commerce Cabinet - Department of Fish & Wildlife Resources

Federal Program: CFDA 15.605 - Sport Fish Restoration  
CFDA 15.611 - Wildlife Restoration

Federal Agency: U.S. Department of the Interior

Pass-Through Agency: Not Applicable

Compliance: Activities Allowed and Allowable Costs

Amounts of Questioned Costs: \$0

During our testing of activities allowed and allowable costs, we noted that internal controls over the approval of vendor invoices should be improved. Based upon our review of FY 2006 invoices, we discovered six (6) invoices that had no supervisory approvals or evidence of the Division Director's pre-approval.

The failure to obtain the appropriate level(s) of invoice approval before payment is an internal control weakness that could lead to incorrect charges to the various federal grant programs, as well as increases the potential for the misappropriation of assets. In addition, management's failure to review and approve invoices greater than \$500 and less than \$1,000 violates the agency's internal policy.

Proper internal control over the payment of vendor invoices requires an appropriate level of review and authorization. In addition, the Department of Fish and Wildlife Resources' internal policy requires that the Division Director pre-approve all invoices for items over \$500 and less than \$1,000.

**Recommendation**

The Department of Fish and Wildlife Resources should implement its internal policies and procedures regarding the payment of vendor invoices. Alternatively, the agency should modify its written policies and procedures regarding the appropriate level(s) of vendor invoice approval. The policies and procedures, however, should include adequate supervisory reviews in order to assure that financial controls are in place, and that internal controls over federal compliance are effective. All such policies and procedure should be communicated to the appropriate staff.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-DFWR3-54: The Department Of Fish And Wildlife Resources Should Implement Its Internal Policies And Procedures Over Vendor Invoice Payments (Continued)**

---

**Management's Response and Corrective Action Plan**

*The Department of Fish and Wildlife Resources agrees with this recommendation. The department has twice issued policy statements over the past two years pertaining to purchase approvals. Current policy requires that any purchases with a cost between \$500 and \$999 requires prior approval—on a completed purchase requisition—by the appropriate Division Director. Any purchases with a cost of \$1,000 or greater requires prior approval—on a completed purchase requisition—by the appropriate Deputy Commissioner. Both levels of approval are processed electronically (email) and forwarded to a centralized email server (Address: FWAccounting.gov) for reference by members of the Administrative Services Division prior to payment. In response to this finding, the Department will re-issue a policy statement to the Administrative Services Division to remind staff of their responsibility for checking the FWAccounting.gov for a completed requisition on all purchases costing \$500 or greater. To further ensure this requirement is upheld, the Division of Administrative Services has already increased staff access to the FWAccounting.gov email repository, and this prerequisite to paying invoices will be added to a previously-established quality control checklist used by accounting staff.*

*In addition to this \$500 threshold, Department employees have been instructed that any purchase of specific items—optical equipment, firearms, ammunition, books, dues or subscriptions, digital cameras, power tools or GPS units—must be pre-approved regardless of the cost. Division Director shall pre-approve these listed items that cost up \$999; Deputy Commissioner shall pre-approve these items that cost \$1,000 or greater. In response to this recommendation, the Department will re-issue a policy statement to all employees to ensure pre-approval for purchase of these specific items as well.*

*Finally, the Department requires that all invoices that total less than \$500 include a signature approval along with the appropriate coding (Accounting template and E-CODE) before payment. This policy will be re-issued in a formal memo.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-DFWR4-55: The Department Of Fish And Wildlife Resources Should Develop Procedures Requiring Cash Draw Downs Within A Reasonable Time Frame, And Requiring Retention Of Supporting Accounting Records**

---

State Agency: Commerce Cabinet - Department of Fish & Wildlife Resources

Federal Program: CFDA 15.605 - Sport Fish Restoration

CFDA 15.611 - Wildlife Restoration

Federal Agency: U.S. Department of the Interior

Pass-Through Agency: Not Applicable

Compliance: Cash Management

Amounts of Questioned Costs: \$0

During our testing of Cash Management internal controls and compliance, we noted that internal controls should be improved with regards to the retention of supporting records, authorization of requests for federal reimbursements, and the timing of requests for federal reimbursements.

We were unable to perform the required testing for a group of federal reimbursements totaling \$222,934 due to the failure by KDFWR to adequately maintain the supporting documentation. The agency was unable to locate any of the documentation related to the particular transaction requested. In addition, we noted that there were no supervisory approvals for two of the federal reimbursement requests totaling \$1,470,959.

Lastly, from our sample tested, we noted one (1) instance where the supporting expenditures had accumulated over a period of eight (8) months before the federal reimbursement request was submitted. In addition, three (3) reimbursement requests included expenditures that accumulated over a four-month period.

The failure to adequately maintain supporting documentation for all transactions raises doubt as to the validity of the transactions, as well as limiting the ability to determine whether transactions are allowable under the appropriate federal programs.

Management's failure to review and approve request for federal reimbursement of program expenditures constitutes an internal control weakness. The results of which may permit errors to go undetected.

The failure to request federal reimbursement of program expenditures within a reasonable period of time places undue burden on the Department of Fish and Wildlife Resources' cash and investments pool, and limits the agency's cash management and earning potential.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-DFWR4-55: The Department Of Fish And Wildlife Resources Should Develop Procedures Requiring Cash Draw Downs Within A Reasonable Time Frame, And Requiring Retention Of Supporting Accounting Records (Continued)**

---

Code of Federal Regulations Title 50: Wildlife and Fisheries, §80.19 - Records, requires, "The State shall maintain current and complete financial, property and procurement records in accordance with the requirements contained in the Federal Aid Manual and OMB Circular A-102." §80.19 paragraphs (a) and (b) require the following:

- (a) Financial, supporting documents, and all other records pertinent to a project shall be retained for a period of three years after submission of the final expenditure report on the project. If any litigation, claim, or audit was started before the expiration of the three-year period, the records shall be retained until the resolution is completed. Records for nonexpendable property shall be retained for a period of three years following final disposition of the property.
- (b) The Secretary and the Comptroller General of the United States, or any of their duly authorized representatives, shall have access to any pertinent books, documents, papers and records of the State.

In addition, in accordance with the Commonwealth of Kentucky's Finance and Administration Cabinet's Manual of Policies and Procedures, Section II: Division of Statewide Accounting Services, Policy No. FAP 120-21-00 Retention of Accounting Documents:

An agency that processes accounting and payment documents shall abide by this document retention policy. An agency using the state's procurement system or accounting system, with pre-audit delegation, shall not provide original source documents to the Finance and Administration Cabinet, and shall maintain such documentation and retain the documents in the agency.

An agency shall maintain the original source document that initiated a transaction and shall maintain a system of tracking that allows for auditing the original source document back to the electronic system.

Sound internal control procedures and accounting practices over "Cash Management" of federal reimbursements suggest that management properly review and authorize requests for federal reimbursements of program expenditures. Such internal controls are necessary in the prevention and /or detection of errors.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-DFWR4-55: The Department Of Fish And Wildlife Resources Should Develop Procedures Requiring Cash Draw Downs Within A Reasonable Time Frame, And Requiring Retention Of Supporting Accounting Records (Continued)**

---

Proper internal controls over cash management activities dictate that the request of federal reimbursements be performed in a timely manner in order to minimize the burden on the agency's resources.

**Recommendation**

The Department of Fish and Wildlife Resources should develop written policies and procedures related to the retention of all necessary supporting accounting records and documentation, supervisory reviews and authorizations, and federal reimbursement requests. The policies and procedures should be communicated to the appropriate staff and readily available for their use. Procedures related to federal reimbursements should specifically address performing draw downs within a reasonable time frame after expenditures are incurred, and incorporate improved supervisory responsibility to ensure the draws are accurate and timely. In addition, staff members and supervisors responsible for cash management should be identified by the department, and properly trained as needed.

**Management's Response and Corrective Action Plan**

*The Kentucky Department of Fish and Wildlife Resources agrees with this recommendation.*

*The Department has had a written schedule in place since March 2003 for purposes of performing the required federal draw downs each month. In MARS, federal draw downs were to be performed no sooner than monthly due to the hard close requirement for all posted expenditures. However, due to short staff and key grant-related vacancies in the Administrative Services Division, this schedule was not always upheld during fiscal year 2006. The Administrative Services Division has been able to fill key accounting and grant analyst vacancies during Fiscal Year 2007. Plus, with the gradual implementation and modifications of EMARS, the Administrative Services Division has automated federal draw downs and is now capable of drawing federal reimbursements in a more consistent and timely manner.*

*Currently, the process requires that the IPA/Grant Analyst select "Allowed for Reimbursement" under the Reimbursement Status field in order to process a receivable document in EMARS that is based on the expenditures charged to their particular grant at a given time. Based on the parameters of the new EMARS*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-DFWR4-55: The Department Of Fish And Wildlife Resources Should Develop Procedures Requiring Cash Draw Downs Within A Reasonable Time Frame, And Requiring Retention Of Supporting Accounting Records (Continued)**

---

**Management's Response and Corrective Action Plan (Continued)**

*system, the department will be able to complete federal draw downs on a timely schedule and in order to at least meet the demands of the federal grant requirements.*

*KDFWR has also established as a separate objective in our overall strategic plan to draw and receive all federal aid reimbursement on a standard and timely schedule. This new objective will be monitored to ensure compliance and will include progress reports for KDFWR management.*

*In support of the EMARS automation and the strategic plan, the Administrative Services Division will develop additional written policies, along with employee training where necessary, to ensure that the appropriate level of supervisory oversight and awareness is in place and more timely requests of federal reimbursements are performed using the above described process.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 2 – FINANCIAL STATEMENT FINDINGS**

**FINDING 06-DFWR5-56: The Department Of Fish And Wildlife Resources Should Develop Policies And Procedures Over Payroll Errors**

---

State Agency: Commerce Cabinet - Department of Fish & Wildlife Resources

Federal Program: CFDA 15.605 - Sport Fish Restoration

CFDA 15.611 - Wildlife Restoration

Federal Agency: U.S. Department of the Interior

Pass-Through Agency: Not Applicable

Compliance: Cash Management

Amounts of Questioned Costs: \$0

During our testing of Cash Management internal controls and compliance, we noted that internal controls should be improved with regards to the handling of payroll errors and the Default Payroll report. It was determined that all employee payroll time charges that are rejected by the payroll reporting system (e.g., due to time reporting errors or failure by an employee to submit a time report) default to Program Budget Unit “DAC0.” For the FY 2006, we reviewed a thirty-four page Default Payroll report, with net adjustments totaling \$12,731.30; however, the total reflects 873 necessary adjustments. Payroll-related corrections for each item in the Default Payroll report are necessary in order to assure proper charges to the various federal grant projects.

The failure to detect payroll-related errors when submitted by the staff prohibits the agency from properly charging the associated grant program. Likewise, in the event that such payroll errors revert to the Default Payroll report, the federal grant programs are not charged until the necessary corrections are performed. Therefore, the agency is not taking advantage of its federally approved funding. The failure to request federal reimbursement of program expenditures within a reasonable period of time places undue burden on the Department of Fish and Wildlife Resources’ cash and investments pool, and limits the agency’s cash management and earning potential.

Proper internal controls over the payroll function, with respect to federal program expenditures, require timely supervisory reviews and verification of the completeness of such program charges. Furthermore, proper internal controls over cash management activities dictate that the request of federal reimbursements be performed in a timely manner in order to minimize the burden on the agency’s resources.

**Recommendation**

The Department of Fish and Wildlife Resources should develop written policies and procedures concerning the handling of payroll errors and the Default Payroll report. To assure propriety of federal grant charges, consideration should be given when determining the appropriate staffing responsible for payroll error and Default



**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-DFWR5-56: The Department Of Fish And Wildlife Resources Should  
Develop Policies And Procedures Over Payroll Errors (Continued)**

---

**Recommendation (Continued)**

Payroll report corrections. The policies and procedures should include management or supervisory approvals. In addition, the policies and procedures should be communicated to the staff responsible and readily available for their use.

**Management's Response and Corrective Action Plan**

*The Kentucky Department of Fish and Wildlife Resources agrees with this recommendation. Internal to the Administrative Services Division, staff shortages and turnover of key grant-related positions during Fiscal year 2006 prevented the department from performing the necessary payroll audits in a timely manner. In order to appropriately perform these payroll audit functions, the department has recently taken action to add another payroll officer—dividing the department's payroll functions by divisions and equally between two employees—and re-filling the grant-related positions. This added staff has been used to ensure that KDFWR's timekeeping policies (to include proper supervisory signature approval and timeliness of the timesheets) are followed accordingly.*

*Also with the added staff, the department will initiate a new policy to require that payroll audits are conducted to correspond to each payroll period, and to include procedures where reports are provided by the payroll officials to the appropriate IPA/grant analyst for review. This responsibility has also been included as part of the IPA/grant analysts responsibility in their official Performance Plans. Upon determination that the payroll default is in error, the IPA and the affected employee's federal aid coordinator shall work together to review the reason for the error and take corrective action. The IPA/Grant Analyst shall perform the correction in EMARS, with the Accounting/Grants Branch supervisors responsible for approving. All corrections must be completed before the next pay-period ends in order to address (and communicate to the field) any mistakes or confusion. This policy will be communicated and training will be provided to all affected staff to ensure compliance.*

*With the formal policies and added staff and quality control, the department is expected to reach and maintain compliance with the payroll audit requirement.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-DFWR6-57: The Department Of Fish And Wildlife Resources Should Inform Staff Of Receipt Handling Policies And Implement Policies Requiring Retention Of Accounting Records And Supporting Documentation**

---

State Agency: Commerce Cabinet - Department of Fish & Wildlife Resources

Federal Program: CFDA 15.605 - Sport Fish Restoration

CFDA 15.611 - Wildlife Restoration

Federal Agency: U.S. Department of the Interior

Pass-Through Agency: Not Applicable

Compliance: Program Income

Amounts of Questioned Costs: \$0

During our tests of program income for Fish and Wildlife Resources (KDFWR), we noted numerous adjusting entries (JV's) to program income and other receipts due to incorrect income classifications throughout the fiscal year. We also noted that the staff was unaware of any written operating policies and procedures related to the processing and recording of cash receipts, including program income.

As part of our testing of Program Income, we found that supporting documentation for Duplicate Hunter Safety Cards was insufficient for part of the FY 2006. KDFWR was unable to provide the supporting documentation for eight (8) Duplicate Hunter Safety Cards for the first half of the fiscal year. As a result, we were unable to verify the accuracy of the recorded income from these. Although this is a repeat record of control weakness noted in the June 30, 2005 Single Audit (Finding 05-DFWR2-49), the agency corrected its record retention policy related to the Duplicate Hunter Safety Cards.

The numerous accounting adjustments made during the year raise concern about the staff's understanding of proper accounting and recording of such funds. The failure to establish and communicate standard operating procedures for the various sources of income (i.e., Wildlife Management Area, Hunter Education, U.S. Army Corps of Engineers, and Tennessee Valley Authority) is an internal control weakness that could lead to the incorrect classification, recording and reporting of program income and other receipts, as well as increases the potential for the misappropriation of assets.

Proper internal controls over the cash handling function require that adequate supporting documentation be maintained. Supporting documentation is necessary in order to perform reconciliations of all receipts to the accounting records, and provide support for the required federal financial status reports.

Maintaining proper supporting documentation enhances the agency's internal controls over cash handling procedures, and thereby decreases the risk of incorrect classification and potential for misappropriation of assets.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-DFWR6-57: The Department Of Fish And Wildlife Resources Should Inform Staff Of Receipt Handling Policies And Implement Policies Requiring Retention Of Accounting Records And Supporting Documentation (Continued)**

---

**Recommendation**

We recommend the Department of Fish and Wildlife Resources establish and implement accounting policies and procedures requiring the retention of supporting documentation for all cash and check receipts.

In addition, we recommend that accounting policies and procedures be developed and implemented requiring formal reconciliations of all receipts to the general ledger system. The reconciliations should be done in a timely manner whereby the results from performing the reconciliations can be addressed, and corrections made as necessary.

During our audit, we were given a copy of the agency's cash handling policies and procedures. KDFWR needs to review their policies and procedures to verify that proper internal controls are in place and that such policies comply with federal requirements, state statutes and administrative regulations, as well as those KDFWR internal policies currently followed. The policies should be clearly communicated and the staff properly trained for all personnel involved in the cash handling process.

**Management's Response and Corrective Action Plan**

*The Department of Fish and Wildlife Resources agrees with recommendation #1. The Department has already established policies and procedures with regards to retaining documentation for cash and check receipts. As indicated above, the Department corrected its record retention shortcoming related to the Duplicate Hunter Safety Cards from last year's audit reflecting FY 2005. The Department also takes advantage of the state's Records Retention Schedule pertaining to accounting and federal grant documents, and thanks to added staff (specifically a new Records Retention Officer and a permanent file clerk) during Fiscal Year 2007, we have been able to effectively manage files, records and supporting documentation.*

*The Department of Fish and Wildlife Resources agrees with recommendation #2. The department has already established policies for FY 2007 to enhance the revenue/cash receipt and documentation process. Excessive staffing changes throughout the Department and Administrative Services Division made it difficult to adequately manage our cash receipts. However, in order to allocate the*

COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-DFWR6-57: The Department Of Fish And Wildlife Resources Should Inform Staff Of Receipt Handling Policies And Implement Policies Requiring Retention Of Accounting Records And Supporting Documentation (Continued)**

---

**Management's Response and Corrective Action Plan (Continued)**

*appropriate oversight and controls necessary to this function, this agency has taken action to fill an accounts receivable position, with a higher level of classification, in the fall of 2006 (Fiscal Year 2007) as well as other key oversight positions. The Administrative Services Division is also developing and updating written policies, training for both field and support employees throughout the Department, and cross training to maintain a formal reconciliation of all revenue receipts to the general ledger system. Specifically, the updated policies include a written reference list to properly code program income and other specific sources of revenue, as well as a formal review of revenue receipts by programmatic and grant analyst personnel on revenue that is unclear. The purpose of these additional reviews is the code and receipt revenue correctly on the front end.*

*The Department of Fish and Wildlife Resources agrees with recommendation #3. As a result of staff attendance and retention issues, cash management responsibilities have periodically shifted throughout the Administrative Services Division. This has resulted in the identification of the need to provide frequent training and re-training to ensure the appropriate handling of receipts. This has resulted in an uncertainty as to the proper procedures and guidelines. However, as stated above, the department has already established policies in FY 2007 to enhance the revenue/cash receipt and documentation process. In order to allocate the appropriate oversight and controls necessary to this function, this agency has taken action to fill an accounts receivable position, with a higher level of classification, in the fall of 2006 (Fiscal Year 2007) as well as other key oversight positions. The Administrative Services Division will ensure that all updated policies and reference materials for the Department's handling of cash/revenue receipts is adequately communicated to all affected staff.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-DFWR7-58: The Department Of Fish And Wildlife Resources'  
Indirect Cost Rates Should Agree To Federally Approved Indirect Cost Rates**

State Agency: Commerce Cabinet - Department of Fish & Wildlife Resources

Federal Program: CFDA 15.605 - Sport Fish Restoration  
CFDA 15.611 - Wildlife Restoration

Federal Agency: U.S. Department of the Interior

Pass-Through Agency: Not Applicable

Compliance: Reporting

Amounts of Questioned Costs: \$0

As part of our testing of internal controls and compliance with regards to Reporting, we determined that internal controls over the application of indirect cost rates for FY 2006 were insufficient. The Department of Fish and Wildlife Resources was unable to reconcile its indirect cost rate calculations to the federally approved "State And Local Department/Agency Indirect Cost Negotiation Agreement" in place for the FY 2006 reporting period. As such, we noted that the indirect cost rates reported in seven (7) of the agency's Financial Status Reports (i.e., Standard Form 269) did not agree to the approved federal cost negotiation agreement rates accepted by the Indirect Cost Coordinator - Cognizant Federal Government Agency.

Although the Department of Fish and Wildlife Resources has not received a formal notification or other correspondence questioning the indirect cost rates reported in the agency's Financial Status Reports, the failure to follow the indirect cost rates established in the Indirect Cost Negotiation Agreement may directly violate the indirect cost provisions set forth in the Office of Management and Budget Circular A-87.

In addition, the lack of administrative oversight and inability to provide adequate supporting documentation for the indirect cost rates applied and reported constitute internal control weaknesses. Consequently, errors in the calculation and allocation of such indirect costs may occur and go undiscovered.

In accordance with the Office of Budget and Management Circular A-87, the requirements noted in federal form "State and Local Department/Agency Indirect Cost Negotiation Agreement," Section I: Rates, specify the type of rate, effective period(s), and the actual rate approved for use in the calculation of all indirect cost allocations. Section II; General, paragraph C., states that "Changes in organizational structure, or changes in the method of accounting for costs which affect the amount of reimbursement resulting from use of the rates in this agreement, require the prior approval of the responsible negotiation agency. Failure to obtain such approval may result in subsequent audit disallowance."

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-DFWR7-58: The Department Of Fish And Wildlife Resources' Indirect Cost Rates Should Agree To Federally Approved Indirect Cost Rates (Continued)**

---

Sound internal control procedures and accounting practices over the calculation, application, and reporting of indirect cost charges require proper oversight and adequate supporting documentation. Such internal controls are necessary in the prevention and /or detection of errors.

**Recommendation**

The Department of Fish and Wildlife Resources should develop written policies and procedures requiring accounting records and documentation be maintained that support the rates and methods used in the calculation of indirect costs charged to the various federal programs. The rates used should agree to those disclosed in the federally approved Indirect Cost Negotiation Agreement. In addition, management should review and approve the indirect expenses and rates disclosed in the Financial Status Reports to verify that the indirect cost rates and charges are properly supported and reconcile to the federally approved rates.

**Management's Response and Corrective Action Plan**

*The Department of Fish and Wildlife Resources agrees with this recommendation. In fiscal year 2006, our agency realized a dramatic turnover in staffing levels in Administration. As a part of the review of existing processes and procedures, the Department reviewed and re-negotiated the existing indirect cost rate agreement with the United States Department of the Interior in order to transition to a Fixed-with-Carry-Forward indirect rate. The Department historically operated under a Provisional/Final indirect cost rate agreement, which was always negotiated annually.*

*The Department of Fish and Wildlife Resources utilized a 67-step cost accounting method in the application of a Provisional/Final indirect rate in fiscal year 2006. The existing Administrative Services staff assigned the responsibility of applying indirect cost recovery had a limited understanding of this process. This method of application calculates overhead/recovery costs based upon the federally applicable salaries and fringe each quarter and allocates recovery per the provisional calculations (based at the previous year's final rate) which do not become a final rate until after the close of the fiscal year. This cost allocation calculates a fluctuating rate of compensation throughout the year, which is to be leveled within the provisionally approved rate at year-end. The Department normally exhibits a higher rate of application during our heavy federal*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-DFWR7-58: The Department Of Fish And Wildlife Resources' Indirect Cost Rates Should Agree To Federally Approved Indirect Cost Rates (Continued)**

---

**Management's Response and Corrective Action Plan (Continued)**

*programmatic months, and a lower rate of application during the months with less federal activity. The reported percentages of recovery are reviewed by our Federal Contracting Officers prior to approval each quarter as reported on the Standard Form 269. The Federal Contracting Officers have approved fluctuating rates historically, while maintaining within the negotiated rates. Any under-recovery would have to be re-negotiated with the Department of the Interior at a later date if it is to be pursued by the Department of Fish and Wildlife Resources. As a result of using this basis of calculation, the rate of application falls at or below the provisional rate approved by our Cognizant Federal Agency (the Department of the Interior).*

*As stated above, the Department pursued and has been granted a Fixed-with-Carry Forward indirect rate effective with fiscal year 2007. This rate is applied as a fixed percentage cost against the base salaries and fringe costs of each grant. The Standard Form 269 contains a formula to apply the percentage appropriately. Calculations are completed annually to determine allowable overhead for each year, and any over or under recovery is adjusted within the indirect formula, which determines the percentage the following year.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-DMA1-59: The Department Of Military Affairs Should Document Costs Charged To The AIOM Tenant Sub-Project, Including An Approved Cost Allocation Plan For Shared Facility Costs**

---

State Agency: Department of Military Affairs

Federal Program: CFDA 12.401 National Guard Military Operations and Maintenance (O&M) Projects

Pass-Through Agency: U.S. Department of Defense

Compliance: Allowable Costs

Amount of Questioned Costs: \$8,003

During FFY04 the Department of Military Affairs (DMA) established a new sub-project (tenant or TR) under the Air Operations and Maintenance (AIOM4) project to account for the costs relating to the use of one of the Louisville facility buildings for weapons of mass destruction (WMD) purposes. O&M costs at sites used for WMD are eligible for 100% federal reimbursement, while the rest of the Louisville facility receives 75% federal reimbursement. The TR subproject budget was \$36,000.

No cost allocation plan covering the facility's shared costs was approved. No expenditures were charged to the TR subproject until April 2006, when DMA reviewed AIOM4 transactions prior to project closure. At that time the entire \$36,000 budgeted amount was transferred from 75% sub-project electrical utility (E212) expenditures to the TR sub-project. Documentation does not support the full amount of this transfer or the subsequent federal billing.

DMA did not prepare a cost allocation plan to divide utility costs at the Louisville site, which has only one electric meter for the entire facility.

DMA charged the full amount budgeted to the TR sub-project as closeout approached. No evidence was found to suggest that documentation of the charge was prepared or reviewed.

The transfer of \$36,000 from the 75% sub-project to the 100% reimbursable TR sub-project triggered a request for federal reimbursement. DMA submitted Partial Payment request #49 dated April 28, 2006 asking for \$8,003. FFY04 utility expenditures at the Louisville site totaled \$467,946. DMA has used 2.528% to calculate the TR sub-project share of utility expenses; assuming this percentage is correct, \$11,830 of utility expense was eligible to transfer to the TR sub-project. If an approved cost allocation plan had been in place, the federal reimbursement for the state's 25% share previously paid would have been \$2,957. However, the entire \$8,003 is a questioned cost in light of the absence of an approved cost allocation plan.



**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-DMA1-59: The Department Of Military Affairs Should Document Costs Charged To The AIOM Tenant Sub-Project, Including An Approved Cost Allocation Plan For Shared Facility Costs (Continued)**

---

The Compliance Supplement (OMB Circular A-133), in its section on compliance requirements for Allowable Costs/Cost Principles relating to centralized costs, states at Part 3B1e:

*Required Certification* - No proposal to establish a central service CAP, whether submitted to a Federal cognizant agency or maintained on file by the governmental unit, shall be accepted and approved unless such costs have been certified by the governmental unit using the Certificate of Cost Allocation Plan as set forth in A-87, Attachment C.

The documentation requirements at Part 3B1d(1) state:

The central service CAP must include all central service costs that will be claimed (either as an allocated or a billed cost) under Federal awards. Costs of central services omitted from the CAP will not be reimbursed.

Further, OMB Circular A-87 Attachment A on Cost Principles for State, Local, and Indian Tribal Governments requires in its basic guidelines at C1j that all costs be adequately documented.

**Recommendation**

The Department of Military Affairs should:

- Prepare and submit for approval a cost allocation plan covering all shared costs to be reimbursed under the AIOM TR sub-project.
- Submit for federal reimbursement only those costs it can document.
- Reimburse the federal government for \$8,003 of undocumented costs.

**Management's Response and Corrective Action Plan**

*Management's goal for the internal control process, within the Dept. of Military Affairs (DMA), is to obtain reasonable assurance that material misstatements will not occur or will be detected in a timely manner. The department's internal control objective for allowable costs is to provide reasonable assurance that federal grant awards are expended only for allowable activities and that the costs of goods and services charged to Federal grant awards are allowable and in accordance with the applicable costs principles. The department's current internal control environment, effected by executive management, establishes*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-DMA1-59: The Department Of Military Affairs Should Document Costs Charged To The AIOM Tenant Sub-Project, Including An Approved Cost Allocation Plan For Shared Facility Costs (Continued)**

---

**Management's Response and Corrective Action Plan (Continued)**

*management's full support of ethical, efficient, and effective internal control activities and sets a positive tone for correction of identified deficiencies.*

*Based on the auditor's findings, DMA management has conducted an analysis of the overall risk environment currently facing the department from this finding and concurs, in part, with the auditor's internal control finding of failing to update the Federal Fiscal Year 2004 (FFY2004) Cost Allocation Plan to specifically address the newly constructed Weapons of Mass Destruction (WMD) tenant building but does not concur with the auditor's findings of questioned costs. However, DMA management will request that the federal grantor review this audit finding and provide instructions concerning the questioned cost.*

*SUMMARY: DMA's review of this finding has determined that the state provided legitimate services to the federal grantor concerning the newly constructed WMD tenant building located on the Louisville National Guard Air Base but the federal grantor did not provide the specific earmarked funding for the new WMD tenant building until Authorized Funding Plan (AFP) modification document number 04-4 (MOD 04-4) was issued on 28 Sep 2004 which was only two days before the end of the grant's period of availability date. This late-in-the-year funding modification to the grant award was done by the federal grantor within FFY2004 but was initially mistaken by the state as being a statement of federal in-kind assistance (i.e. federal government paying the WMD building directly) and therefore not a 'spend-able' federal grant budget authorization for the state utilize. The state's erroneous perception of the new \$36,000 AFP 100% funding as being federal in-kind assistance for the new WMD building was corrected when AFP MOD 04-5 was issued on 4 February 2005. But, since the new, earmarked WMD funding had been provided only two days prior to the end of the grant period, the state then had no other option than to Journal Voucher transfer costs that had previously been paid in unfunded support of the WMD building and were eligible and legitimate costs which had occurred within the grant's period of availability. These costs were then Journal Voucher transferred to this new, earmarked, and fully funded 100% WMD tenant account in order comply with the new, federal funding AFP budget provisions. The state's internal accounting adjustment of previously paid, legitimate grant costs did not result in any additional federal billings other than to properly adjust previous state payments made in support of the WMD tenant building that had been made from a 75%*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-DMA1-59: The Department Of Military Affairs Should Document Costs Charged To The AIOM Tenant Sub-Project, Including An Approved Cost Allocation Plan For Shared Facility Costs (Continued)**

---

**Management's Response and Corrective Action Plan (Continued)**

*federally reimbursable account to the new 100% federally reimbursable account that was now specifically earmarked for the new WMD tenant building costs. Also, since the earmarked funding was provided at the very end of the grant period and after all federal fiscal year grant costs had been paid, the federally approved Cost Allocation Plan that had been in effect during the FFY2004 period of availability did not address how infrastructure costs for the entire Air Base could be prorated to determine the costs chargeable to the specific WMD tenant building.*

*DISCUSSION: To fully comprehend the necessity of the state's accounting action, one must understand the timeline of events. The period of availability for the Air Guard Organization & Maintenance FFY2004 grant award (AIOM4) was from 1 October 2003 to 30 September 2004 which covered Federal Fiscal Year 2004. The un-liquidated cleanup suspense date that is required by federal regulation was 31 December 2004.*

*This Air National Guard Organization & Maintenance FFY2004 (AIOM4) grant was incrementally funded (as per federal regulation) from 1 Oct 2003 up through 30 Sep 2004 by three Authorized Funding Plan (AFP) modification documents (MOD's 04-1, 04-3, 04-4) which originally earmarked a total of \$67,200 for Administrative Support costs (which was 100% federally reimbursable) and originally earmarked a total of \$946,100 for Infrastructure Support & Maintenance costs (which was 75% federally reimbursable). The originally earmarked 100% Admin Support funds could only be used to pay for a property officer's salary and admin support cost allocated salaries and the originally earmarked 75% Infrastructure funds could only be used to pay for support staff and utility costs for the Louisville National Guard Air Base as it existed at that time (i.e. before completion of the WMD tenant building). Neither of these original AFP budget earmarks, that were in effect for the entire FFY2004 period, contained any new funding for the new WMD building which was, at that time, under construction. Historically, this original AFP budgeted funding design was the normal and reoccurring, federally required, budget and eligibility breakdown of this grant award.*

*During the FFY2004 period of availability of this grant award, a new WMD building was constructed on the Air Base which was intended to be 100%*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-DMA1-59: The Department Of Military Affairs Should Document Costs Charged To The AIOM Tenant Sub-Project, Including An Approved Cost Allocation Plan For Shared Facility Costs (Continued)**

---

**Management's Response and Corrective Action Plan (Continued)**

*federally reimbursable when completed. However, the during the construction of this new building, no provisions were made for separate utility meters and, consequently, the building was tied directly into the utility and other services that metered and served the entire Air Base. When the WMD building was completed in March 2004, the state continued to pay the infrastructure bills for the entire Air Base which, unknowingly, contained costs for the new WMD building. The additional WMD building costs, which were erroneously included in the invoices for the entire Air Base, caused the state to exceed the AFP MOD 04-4 stipulated budgets of \$67,200 for Administrative Support costs (which was 100% federally reimbursable) and the \$959,100 federal AFP for the 75% Infrastructure costs account. This AFP funding deficit was identified to the federal grantor which is the United States Property and Fiscal Office for Kentucky (USP&FO) who investigated the problem.*

*Once USP&FO determined what was causing the budgeted funding problem, they issued AFP MOD 04-5 on 4 Feb 2005 which contained slight adjustments in the two previously stipulated earmarks (100% Admin Spt and 75% Infrastructure & Maintenance) but again contained the new budget earmarking of \$36,000 exclusively for the WMD tenant building costs which was designated as 100% federally reimbursable. Since this new earmarked funding was originally provided at the very end date of the grant award and the specific costs of the WMD building had already been paid and were intermixed with the previously paid Air Base costs, the state had no other option than to Journal Voucher transfer these previous costs from the over-spent 75% reimbursable Infrastructure account to the proper 100% WMD account in order to comply with the revised federal AFP budget. Therefore, this cost transfer in question was necessary to fully comply with the revised, federally required AFP earmarked budget categories.*

*Simply put, it was physically and financially impossible for DMA to post WMD building costs to the new 100% federally funded WMD AFP budget account at the time the these costs were incurred because the federal AFP funding authority for this specific building did not exist from March 2004 (the time the WMD building was completed) until two days before the end of the grant award.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-DMA1-59: The Department Of Military Affairs Should Document Costs Charged To The AIOM Tenant Sub-Project, Including An Approved Cost Allocation Plan For Shared Facility Costs (Continued)**

---

**Management's Response and Corrective Action Plan (Continued)**

*CONCLUSION: While one can argue that the FFY2004 Cost Allocation Plan was old and out of date at the time of the WMD building cost transfer and should have been updated to support the later Journal Voucher transfer of previously paid WMD building costs to the grant, and one can argue that the Journal Voucher coding should not have been done as one lump sum and instead have been done as specific cost transfers, however, one can't argue with the fact that the \$36,000 cost that was transferred to the WMD budget AFP were legitimate costs to the federal government which had been incurred by the state for payment of infrastructure costs for the entire Air Base (which had included the WMD building) during the period of availability of the AIOM4 grant.*

**Auditor's Reply**

The only documentation provided to the auditor for costs related to the WMD building covered utilities in the amount of \$11,830. The remaining \$24,169 has not been documented. Further, according to the regulations cited above, shared costs are not reimbursable unless a cost allocation plan has been approved, so the entire \$8,003 paid to DMA as a result of the transfer of costs from the 75% sub-project to the TR sub-project is a questioned cost.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-DMA2-60: The Department Of Military Affairs Should Properly Request And Document Grant Extensions**

---

State Agency: Department of Military Affairs

Federal Program: CFDA 12.401 National Guard Military Operations and Maintenance (O&M) Projects

Pass-Through Agency: U.S. Department of Defense

Compliance: Period of Availability

Amount of Questioned Costs: \$6,332

The Department of Military Affairs (DMA) failed to comply with federal requirements concerning Period of Availability of Federal Funds. Seven projects recorded transactions more than 90 days after the project closing date, but no documentation exists of approval for an extension by the United States Property and Fiscal Officer for Kentucky (USPFO) on behalf of the National Guard Bureau (NGB).

All seven federal awards listed above cover one federal fiscal year, October 1 to September 30. The Master Cooperative Agreement between the National Guard Board and the Commonwealth of Kentucky, which governs the awards, allows 90 days after the end of the federal fiscal year for liquidating claims, disbursing obligations, and preparing a final accounting for the award. The USPFO is allowed to extend the time required to accomplish this for good cause shown, and such extensions are frequently permitted. However, no record exists of extensions granted for the seven awards listed above.

Transactions for each of the four awards listed took place more than 90 days after the applicable project closing date. They are described below:

<b>Project</b>	<b>Total</b>	<b>Description</b>
AIFS3	\$ 117	Correct object
AIFS4	\$ 1,093	
AYCM4	\$ 593	
AIFF5	\$ 4,529	

Total questioned costs as detailed above are \$6,332.

A Master Cooperative Agreement between the National Guard Board and the Commonwealth of Kentucky governs these awards. Section 306b addresses the deadline, stating, "If unliquidated claims and undisbursed obligations arising from the State's performance of the agreement will remain 90 days or longer after the close of the fiscal year, the State shall provide a detailed listing of uncleared obligations and a projected timetable for the liquidation and disbursement no later than 31 December. The USPFO shall then set an appropriate new timetable for the State to submit their final accounting."

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-DMA2-60: The Department Of Military Affairs Should Properly Request And Document Grant Extensions (Continued)**

---

Section 306c states, "Costs incurred in a fiscal year which are not disclosed by the State within 90 days of the end of the fiscal year, except costs associated with unliquidated claims and undisbursed obligations arising from the State's performance of the agreement which the State has reported, shall not be eligible for reimbursement by NGB. The USPFO may extend the 90-day limit for good cause shown." Costs incurred more the 90-day limit has passed are therefore allowable only if an extension has been granted.

**Recommendation**

We recommend that the Department of Military Affairs comply with Period of Availability of Federal Funds requirements by requesting and documenting an extension from the USPFO whenever transactions relating to an award have not been completed by the following December 31.

**Management's Response and Corrective Action Plan**

*Management's goal for the internal control process, within the Dept. of Military Affairs (DMA), is to obtain reasonable assurance that material misstatements will not occur or will be detected in a timely manner. The department's internal control objective for period of availability principles is to provide reasonable assurance that Federal grant awards are used only during the authorized period of availability. The department's current internal control environment, effected by executive management, establishes management's full support of ethical, efficient, and effective internal control activities and sets a positive tone for correction of identified deficiencies.*

*Based on the auditor's findings, DMA management has conducted an analysis of the overall risk environment currently facing the department from this finding and concurs, in part, with the auditor's internal control finding of the lack of written un-liquidated cost lists for the minor Army and Air National Guard grants but does not concur with the auditor's findings of questioned costs. However, DMA management will request that the federal grantor review this audit finding and provide instructions concerning the questioned cost.*

**DISCUSSION:**

*The federal grantor has previously provided information to the auditor concerning the use of their quarterly un-liquidated meetings to coordinate these minor DoD Cooperative Agreement un-liquidated costs that occur after the un-liquidated cleanup date of 31 Dec. However, subsequent to the previous audit*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-DMA2-60: The Department Of Military Affairs Should Properly Request And Document Grant Extensions (Continued)**

---

**Management's Response and Corrective Action Plan (Continued)**

*finding, the federal grantor has decided that, from now on, all DoD Cooperative Agreement extensions will be via written lists.*

***Specific Response to Air Guard Family Support (AIFS) grant period availability finding.*** Both the AIFS3 and AIFS4 grants had an ending period of availability date of 9/30/2004 and an un-liquidated cleanup date of 12/31/2004. However, the federal grantor specifically allowed the later AIFS workers' compensation premium payment costs as was stated in an email from the federal Grants Officer Representative dated 21 July 2005 and, therefore, this \$1,211.23 cost fully complies with Section 306c of the Master Cooperative Agreement and should not be a questioned cost.

*The original DMA expenditure for the AIFS3 and AIFS4 questioned charges occurred on 7/28/2005 (via Payment Voucher PV 095 IIC47002927) which was coded for cost distribution by use of the MARS Cost Allocation process. This process collects all costs posted to it for a period of one fiscal month and then makes distribution of those costs during the Cost Allocation run cycle which actually occurs at the being of the following month. This Cost Allocation distribution process ran on 8/4/2005 and distributed the appropriate charges to these grants at that time via Journal Voucher (JV 095 CA012300041). However, the original Payment Voucher contained an internal coding error in the payment coding which labeled the cost as 'E431 Grants-In-Aid State Govt. Entities' instead of the correct label of 'E131 Workers' Compensation Premium'. This was an internal accounting error for which JV 095 JVC00095983 was subsequently processed on 8/8/2005 to correct the erroneous internal coding. This Journal Voucher internal accounting correction in no way charged the federal government any additional amounts above the original 7/28/2005 un-liquidated charge that was specifically coordinated with the federal grantor before payment was made.*

***Specific Response to the Air Guard Firefighters (AIFF) grant period availability issue.*** The AIFF5 grant had an ending period of availability of 9/30/2005 and an un-liquidated cleanup date of 12/31/2005. Part of the eligible expenditures for this grant is the purchase of specialized clothing and instruments of which two purchases occurred on 1/3/2006. The payment documents PV 095 I-06001431 purchased clothing and PV 095 I-06001733 purchased instruments and apparatus against purchase order PO 095 C-05352083. These payment



**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-DMA2-60: The Department Of Military Affairs Should Properly Request And Document Grant Extensions (Continued)**

---

**Management's Response and Corrective Action Plan (Continued)**

*documents posted to the accounting system 3 days after the end of the un-liquidated cleanup date.*

***Specific Response to the Army Communications (AYCM) grant period availability issue.** The AYCM4 grant had an ending period of availability of 9/30/2004 and an un-liquidated cleanup date of 12/31/2004. It is inexplicable why these two telecom usage charges were paid from the AYCM4 grant instead of the AYCM5 grant to which they were eligible. Both the questioned charges are un-liquidated cleanup payments for COT Telecom circuit usage that occurred during the period of eligibility of the AYCM5 grant. The first payment was on 11/10/2005 via PV 095 PV5311A0030 for \$352, which covered the monthly telecom usage period to 10/1/2005 (i.e. September 2005 usage). The second payment was on 11/15/2005 via PV 095 PV5280A0028 for \$241, which covered the monthly telecom usage period to 9/1/2005 (i.e. August 2005 usage). However, it should be noted that the federal grantor reimbursed these FFY05 eligible costs from the FFY04 AYCM4 federal funding instead of from the FFY05 AYCM5 federal funding to which these charges should have been posted by the state. This improper federal fiscal year billing by the state did not increase the federal reimbursement above that which was correctly due the state from the following federal fiscal year funds.*

**Auditor's Reply**

We have reviewed the supporting documentation DMA has presented to support federal approval of \$1,211 of the questioned costs to AIFS3 and AIFS4. While the correspondence indicated that the federal agency was aware of the potential charges, it did not clearly indicate their approval of the charges after the period of availability for grant funds had expired. DMA has confirmed expenditures occurred after the un-liquidated cleanup date on all four projects. AYCM4 apparently involved a clerical error that was not caught, but the other transactions were assigned to the intended project year. DMA has not documented federal approval of extensions to any of the projects.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-DWI8-61: The Department For Workforce Investment Should Ensure Federal Reports Reconcile To The State's Accounting System On A Quarterly Basis By Reporting Category**

---

State Agency: Department For Workforce Investment  
Federal Program: CFDA 17.258 - WIA Adult Program  
CFDA 17.259 - WIA Youth Activities  
CFDA 17.260 - WIA Dislocated Workers  
Federal Agency: U.S. Department of Labor  
Pass-Through Agency: Not Applicable  
Compliance Area: Reporting  
Amount of Questioned Costs: \$0

During our review of internal controls over reporting for the Workforce Investment Act (WIA) grant, administered by the Office of Employment and Training (OET), we noted all WIA funds are initially coded to 6500-0050 (unclassified reporting category) when drawn down into MARS. For supporting documentation, OET prepares summary expenditure reports that total expenses reported by each Local Workforce Investment Area (LWIA) location.

For the FY 03 and FY 05 December quarterly reports, draw downs posted to reporting category 6500-0050 by grant in MARS did not reconcile to the expenditures reported on the Financial Status Reports and did not agree in total to MARS as follows:

For grants 27004, 27204, and 27404:

Report Area	DWI Documentation	MARS	Difference
Total Statewide (0720)	568,711	181,131	(387,581)
Rapid Response (0730)	55,282	36,869	(18,413)
Rapid Response Additional Assistance (0735)	922,495	85,385	(837,110)
Administrative (0740)	1,735,970	527,972	(1,207, 998)
Adult Program (0750)	2,693,377	2,373,342	(320,035)
Dislocated Worker (0800)	1,916,165	1,382,932	(533,233)
Youth (0850)	12,231,633	7,874,883	(4,356,750)

For the FY 03 and FY 04 June closeout reports, draw downs posted to reporting category 6500-0050 by grant in MARS did not reconcile to the summary expenditure reports by category. However, the expenditure data submitted by OET did agree in total to MARS at the time the grant was closed-out.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-DWI8-61: The Department For Workforce Investment Should Ensure Federal Reports Reconcile To The State's Accounting System On A Quarterly Basis By Reporting Category (Continued)**

---

The WIA grant must meet several earmarking requirements. The final Financial Status Reports show expenditure amounts, which are used to calculate percentages for earmarking requirements. When using the expenditure amounts from the Financial Status Reports, the state appears to be in compliance with earmarking requirements. However, since we cannot agree MARS to the Financial Status reports by category, we cannot be certain earmarking requirements were met.

Personnel responsible for posting the expenditures to MARS are not utilizing the correct reporting category. As a result of these errors, inaccurate data could be sent to the federal government. Also, DWI may not be in compliance with the earmarking requirements.

Good internal controls dictate the accounting system properly reflects the expenditures for the WIA grants and that the federal reports agree or be reconciled to the accounting system. OMB Compliance supplement, Part 3 under reporting indicates auditors should be able to review auditee records and "...trace the amounts reported to accounting records that support the audited financial statements and the schedule of expenditures of Federal awards and verify agreement or perform alternative procedures to verify the accuracy and completeness of the reports and that they agree with the accounting records."

**Recommendation**

We recommend OET:

- perform quarterly reconciliations to ensure that draw downs posted to reporting category 6500-0050 by grant in MARS reconcile to the expenditures reported on the Financial Status Reports.
- update policy and procedures manual to include instructions for personnel responsible for posting transactions to MARS to ensure that the proper reporting categories are being utilized.

COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-DWI8-61: The Department For Workforce Investment Should Ensure Federal Reports Reconcile To The State's Accounting System On A Quarterly Basis By Reporting Category (Continued)**

---

**Management's Response and Corrective Action Plan**

*OET disagrees with all aspects of this finding, especially the apparent questioning of \$7,661,120 of costs, and respectfully requests that it be excluded from the final report.*

*In regard to the portions of the finding which state, "For the PY 03 & FY05 December quarterly reports, draw downs posted to reporting category 6500-0050 by grant in MARS did not reconcile to the expenditures reported on the Financial Status Reports and did not agree in total to MARS" and "For the PY 03 & FY 04 June closeout reports, draw downs posted to reporting category 6500-0050 by grant in MARS did not reconcile to the summary expenditure reports by category", OET explained that the draw down amounts will not reconcile to the Financial Status reports at the end of each quarter and will not reconcile until the grant is closed-out. The LWIA expenditures posted in MARS under 6500-0050 are recorded on a **cash basis** and the US Department of Labor requires the Financial Status reports to be submitted on an **accrual basis**. Therefore, OET uses LWIA summary roll-up reports for the WIA grants as a basis for filing the Financial Status reports related to the LWIA expenditures at the end of each quarter. These reports are submitted monthly by the LWIAs and reflect accrued expenses for all active WIA grants. OET uses the expenses recorded in MARS to file the close-out reports. This has occurred as evidenced by the statement made in the finding that, "the expenditure data submitted by OET did agree in total to MARS at the time the grant was closed-out."*

*The US Department of Labor instructions state:*

- *Financial Reporting - The Basics*
  - *Form: Standard Form -269 (long form)*
  - *Basis: accrual accounting method*
- *Why Accrual Method of Accounting*
  - *Accrual basis provides more reliable financial information for effective management and accountability*
  - *Transactions are recorded in the accounting period in which they occur -regardless of when the related cash receipts and disbursements take place*
  - *Cash basis understates true spending*
  - *Failure to report on the accrual basis may result in the loss of funds*

COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-DWI8-61: The Department For Workforce Investment Should Ensure Federal Reports Reconcile To The State's Accounting System On A Quarterly Basis By Reporting Category (Continued)**

---

**Management's Response and Corrective Action Plan (Continued)**

*Therefore, the Recommendation: We recommend OET perform quarterly reconciliations to ensure that draw downs posted to reporting category 6500-0050 by grant in MARS reconcile to the expenditures reported on the Financial Status Reports, would be contrary to federal instructions from the US Department of Labor.*

*In regard to the proper reporting categories to be used to track WIA expenses, OET records all WIA expenses in the following categories as required to compile the Financial Status reports: **Statewide Reserve, Statewide Administration, Rapid Response, Local Administration, Local Adult, Local Youth and Local Dislocated Worker**. OET does not use the Reporting Categories used in MARS as depicted in the chart above (0720, 0730, etc.) to determine amounts reported on the Financial Status reports, but uses the revised Chart of Accounts as indicated on the attached Chart of Accounts chart. OET uses certain characters in the Project number to designate the categories. For example, project **2740501** indicates the following: **274** indicates PY Youth, **05** indicates the grant is PY04 WIA and **01** indicates it is a Statewide Reserve project. **2710603** translate to: **271** indicates FY Dislocated Worker, **06** indicates the grant is FY06 WIA and **03** indicates that it is Rapid Response. OET incorporated this coding scheme to track all WIA expenditures in MARS to a level that enables them to be reconciled to the Financial Status reports and enable the auditors to determine compliance with the earmarking requirements.*

*As stated in the Criteria, Good internal controls dictate the accounting system properly reflects the expenditures for the WIA grants and that the federal reports agree or be reconciled to the accounting system. Furthermore it states, "...trace the amounts reported to accounting records that support the audited financial statements and the schedule of expenditures of Federal awards... ...and they agree with the accounting records." Through OET's WIA Chart of Accounts and tracking/reconciliation process, OET is in compliance with the above "Criteria."*

*Additionally, in response to the Recommendation: We recommend OET update policy and procedures manual to include instructions for personnel responsible for posting transactions to MARS to ensure that the proper reporting categories are being utilized, OET is posting to the proper reporting categories as defined by the WIA Chart of Accounts.*

COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-DWI8-61: The Department For Workforce Investment Should Ensure Federal Reports Reconcile To The State's Accounting System On A Quarterly Basis By Reporting Category (Continued)**

**Management's Response and Corrective Action Plan (Continued)**

			<i>e-MARS</i>
274-YT-06			270 PY Local Adult
			272 PY Local Dislocated Workers
			274 PY Local Youth
			271 FY Local Dislocated Workers
			273 FY Local Adult
			YT Youth
			AD Adult
			DW Dislocated Worker
			SA State Administration
			SR State Reserve
			RR Rapid Response
			LA Local Administration
			05 April 2004 to June 2005 (PY grants)
			06 April 2005 to June 2006 (PY grants)
			07 April 2006 to June 2007 (PY grants)
			05 October 2004 to June 2005 (FY grants)
			06 October 2005 to June 2006 (FY grants)
			07 October 2006 to June 2007 (FY grants)

			<i>MARS</i>
274-06-00Z			270 PY Local Adult
			272 PY Local Dislocated Workers
			274 PY Local Youth
			271 FY Local Dislocated Workers
			273 FY Local Adult
			00Z Youth
			ADZ Adult
			DWZ Dislocated Worker
			02Z State Administration
			01Z State Reserve
			03Z Rapid Response
			05 April 2004 to June 2005 (PY grants)
			06 April 2005 to June 2006 (PY grants)
			07 April 2006 to June 2007 (PY grants)
			05 October 2004 to June 2005 (FY grants)
			06 October 2005 to June 2006 (FY grants)
			07 October 2006 to June 2007 (FY grants)

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-DWI8-61: The Department For Workforce Investment Should Ensure Federal Reports Reconcile To The State's Accounting System On A Quarterly Basis By Reporting Category (Continued)**

---

**Auditor's Reply**

Regarding the agency's comment, "*the apparent questioning of \$7,661,120 of costs. . . .*," the auditor did not question costs. The chart in the finding indicates the differences in expenditures between MARS and the December Quarterly Financial Status Report supporting documentation for grants 27004, 27204, and 27404. The chart does not include the unclassified expenditures (Category 0050) of \$8,093,125 because these expenditures were not associated with a category.

Regarding the comment that the auditor's recommendation to perform quarterly reconciliations "*would be contrary to federal instructions from the US Department of Labor,*" we acknowledge the agency appropriately used the accrual basis of accounting on the Financial Status Reports. However, a reconciliation documenting the agreement of MARS expenditures and LWIA expenditures by reporting category, with an adjustment for the accrual amount is a good internal control and would not be reported on the Financial Status Report and would thus not be contrary to the USDOL reporting instructions. The accrual adjustment would not be recorded in MARS, but in the supporting reconciliation.

We are aware that the draw amounts do not reconcile to the Financial Status Reports at the end of each quarter. However, reconciliation between draw amounts and the Financial Status Reports should be performed at the end of each quarter.

Regarding the final Financial Status Report for a grant, MARS data should agree by reporting category, not just in total. Due to the fact that MARS data did not agree by category, we could not verify the accuracy of the information submitted to the Federal government. Earmarking requirements are based on the expenditures reported on the Financial Status Reports. Since we could not verify the information on the reports, we can also not be certain the earmarking requirements were met.

OMB Circular A-133 states agencies should be able to "...trace the amounts reported to accounting records that support the audited financial statements and the schedule of expenditures of Federal awards and verify agreement or perform alternative procedures to verify the accuracy and completeness of the reports and that they agree with the accounting records."

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-DWI8-61: The Department For Workforce Investment Should Ensure Federal Reports Reconcile To The State's Accounting System On A Quarterly Basis By Reporting Category (Continued)**

---

**Auditor's Reply (Continued)**

Further, United States Code Title 29, Section 2935 (a) (1) states, "Recipients of funds under this title shall keep records that are sufficient to permit the preparation of reports required by this title and to permit the tracing of funds to a level of expenditures adequate to ensure that the funds have not been spent unlawfully."

OET comments that, "Through OET's WIA Chart of Accounts and tracking/reconciliation process, OET is in compliance with the above 'Criteria.'" In addition, OET comments that, OET is posting to the proper reporting categories as defined by the WIA Chart of Accounts." The auditor was not able to reconcile or track the information on the Financial Status Report to MARS by using the information provided by OET at the time of our audit. We will review the additional information provided regarding the "Chart of Accounts" during our FY 07 audit.



**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-DWI9-62: The Department For Workforce Investment Should Improve Review Procedures Over The Office Of Vocational And Adult Education Consolidated Annual Report Status Of Funds Form**

---

State Agency: Department for Workforce Investment

Federal Program: CFDA 84.048 - Vocational Education Basic Grants to State

Federal Agency: U.S. Department of Education

Pass-Through Agency: Not Applicable

Compliance Area: Reporting and Matching

Amount of Questioned Costs: \$0

DWI did not report the correct amounts to the Federal government on the Office of Vocational and Adult Education Consolidated Annual Report (OVAECAR) Status of Funds Form (final) for KY 2004-2005. The OVAECAR, reporting the status of the Vocational Education grant funds, showed \$1,366,542 as the Non-Federal Share of Outlays. However, the state's accounting system (MARS) showed \$1,600,959, a difference of \$217,023. After discussions with agency personnel, it was determined the wrong data from the wrong fiscal year was used on an amended report. DWI used the amounts for FY 03 instead of FY 04.

The agency submitted amended reports in response to another finding issued in the prior fiscal year related to an incorrect match. The prior year finding, 05-DWI11-59, noted the amounts being used to report the state match were incorrect and not traceable to the Treasury reports for accuracy.

The cause of this problem is due to a lack of proper internal controls and management oversight. The amended OVAECAR sent to the Federal government showed a \$217,023 understatement in the Non-Federal Share of outlays.

Good internal controls dictate financial information provided to the Federal government be accurate and verifiable by the accounting records.

OMB Circular A-133 requires amounts reported on Federal reports be traced to audited financial records. OMB states you should be able to "...trace the amounts reported to accounting records that support the audited financial statements and the schedule of expenditures of Federal awards and verify agreement or perform alternative procedures to verify the accuracy and completeness of the reports and that they agree with the accounting records."

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-DWI9-62: The Department For Workforce Investment Should Improve Review Procedures Over The Office Of Vocational And Adult Education Consolidated Annual Report Status Of Funds Form (Continued)**

---

**Recommendation**

We recommend DWI:

- Ensure the information provided to the Federal government agrees with the financial data in MARS (or eMARS for years ended after June 2006).
- Verify the numbers prior to the submission of the report to the Federal government.

**Management's Response and Corrective Action Plan**

*DWI agrees with the finding and in accordance with the auditor's recommendation will more carefully verify the accuracy of the financial data being reported to the OVAE before submission of the reports.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-JUST1-63: The Justice Cabinet Should Implement Procedures To  
Ensure Subrecipient A-133 Audits Are Submitted Timely**

---

State Agency: Justice Cabinet - Office of the Secretary  
Federal Program: CFDA 16.575 - Crime Victim Assistance  
CFDA 16.579 - Byrne Formula Grant Program  
Federal Agency: U.S. Department of Justice - Office of Justice  
Pass-Through Agency: Not Applicable  
Compliance Area: Subrecipient Monitoring  
Amount of Questioned Costs: \$0

For both grant programs reviewed, A-133 audits were consistently submitted late by subrecipients. The Grants Management Branch (GMB) did not document their attempts to obtain each A-133 audit, when an A-133 audit was required. For CFDA 16.579, six of ten subrecipients that were tested submitted their A-133 audits late. For CFDA 16.575, seven of ten subrecipients that were tested submitted their A-133 audits late.

During FY 2006, GMB did not perform sufficient subrecipient monitoring activities related to A-133 audits. GMB has not both tracked required A-133 audits and taken affirmative steps to ensure that these audits are submitted to GMB in a timely manner.

OMB Circular A-133 has requirements for subrecipient audits - (1) Ensuring that subrecipients expending \$500,000 or more in Federal awards during the subrecipient's fiscal year have met the audit requirements of OMB Circular A-133 and that the required audits are completed within 9 months of the end of the subrecipient's audit period, (2) issuing a management decision on audit findings within 6 months after receipt of the subrecipient's audit report, and (3) ensuring that the subrecipient takes timely and appropriate corrective action on all audit findings. In cases of continued inability or unwillingness of a subrecipient to have the required audits, the pass-through entity shall take appropriate action using sanctions.

**Recommendation**

We recommend that GMB should have procedures in place to ensure that A-133 audits are submitted on time and document attempts to obtain late A-133 audits.

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-JUST1-63: The Justice Cabinet Should Implement Procedures To  
Ensure Subrecipient A-133 Audits Are Submitted Timely (Continued)**

---

**Management's Response and Corrective Action Plan**

*Justice and Public Safety Cabinet does not dispute this finding. Historically, an audit has been required with each grant application cycle, resulting in approximately annual submissions of A-133 audits for continuation subgrantees. Separate requests for subsequent audits within 9 months of subgrantees' fiscal year end (as required by OMB Circular A-133) have previously not been made.*

*To remedy this situation, Grants Management Branch will utilize the "next date due" field for A-133 audits in its master database as the basis to generate subgrantee reminder notices. A periodic roster of awardees with A-133 audit updates due will be generated, and each will receive a reminder notice via email 30 days in advance of their due date. The database manager will oversee this function, and follow-up notices for delinquent submissions will be documented. In the future, upon acquisition of an electronic grants management system, this function will be automated.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-JUST2-64: The Justice Cabinet Should Implement Procedures For  
The Timely Submission Of Subrecipient Financial Reports**

---

State Agency: Justice Cabinet - Office of the Secretary

Federal Program: CFDA 16.575- Crime Victim Assistance

CFDA 16.579- Byrne Formula Grant Program

Federal Agency: U.S. Department of Justice - Office of Justice Programs

Pass-Through Agency: Not Applicable

Compliance: Subrecipient Monitoring

Amount of Questioned Costs: \$0

Grants Management Branch (GMB) policies require grant subrecipients to submit quarterly financial reports fifteen days after the end of the quarter. GMB has not enforced this requirement. Auditor testing showed subrecipient financial reports were consistently submitted late.

During FY 2006, GMB did not perform sufficient monitoring activities related to subrecipient financial reports. If subrecipients are not in compliance with federal requirements, grant funds could be spent erroneously when adequate monitoring is not timely performed.

OMB A-133 includes subrecipient monitoring requirements. For subrecipients who are not required to have an audit as stipulated in OMB Circular A-133, the recipient is still responsible for monitoring the subrecipients' activities to provide reasonable assurance that the subrecipient administered Federal awards in compliance with Federal requirements.

**Recommendation**

We recommend that GMB implement procedures for monitoring the timely submission of subrecipient financial reports.

**Management's Response and Corrective Action Plan**

*The Justice and Public Safety Cabinet acknowledge that certain Byrne subgrantee financial reports have been received after brief, or even extended, delays. And, documentation of delinquency notification or other follow-up has not been consistently maintained in subgrantee files.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-JUST2-64: The Justice Cabinet Should Implement Procedures For  
The Timely Submission Of Subrecipient Financial Reports (Continued)**

---

**Management's Response and Corrective Action Plan (Continued)**

*However, no reimbursement is made until reports are received and approved, so federal funds are not made available to the subgrantee for erroneous expenditure. And, all required reports must be received prior to subgrant closeout. (As previously noted, there is one exception to this rule – in the limited case of “participating” grants to state agencies administered in the MARS system, the nature of this setup allows for reimbursement of expenditures prior to formal approval by GMB due to the volume of transactions. However, prior to subgrant closeout, all such agencies’ reports must be received and approved, allowability of all expenditures is determined, and appropriate Journal Vouchers are initiated to resolve any disallowed expenditures. As Byrne grants are replaced by JAG grants, the number and amount of “participating” grants is being vastly reduced).*

*Withholding of funds is the primary enforcement mechanism available for delinquent submission of financial and/or programmatic reports, and subgrantees are advised that past performance (e.g., consistent reporting delinquency) may be considered in future application cycles. However, Grants Management Branch will more vigorously pursue delinquent reports in the future, and document these efforts to the subgrantee’s file.*

*In the future, written notice will be sent to subgrantees with delinquent quarterly reports on the 16<sup>th</sup> of the month following each quarter (or the first business day thereafter). Such written notice will be repeated on or about the 15<sup>th</sup> and 30<sup>th</sup> of each month until the delinquency is cured. For those grantees submitting monthly reports, notices will be sent according to the quarterly schedule if they are not in compliance. In the future, upon acquisition of an electronic grants management system, this function will be automated. All such notices, and relevant subgrantee responses, will be retained in the subgrantee’s file.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-KHEAA1-65: The Kentucky Higher Education Assistance Authority  
Should Send Notices To Borrowers Timely**

---

State Agency: Kentucky Higher Education Assistance Authority  
Federal Program: CFDA 84.032 - Federal Family Education Loans  
Federal Agency: U.S. Department of Education  
Pass-Through Agency: Not Applicable  
Compliance: Reporting  
Amount of Questioned Costs: \$0

Out of a sample of 40 loans, we noted that, for 38 of these, the required notices to borrowers in default were not sent on a timely basis. Federal regulations state that "Within a reasonable time after all of the information described in paragraph (b)(6)(v) of this section has been sent, the agency must send at least one notice informing the borrower that the default has been reported to all national credit bureaus (if that is the case) and that the borrower's credit rating may thereby have been damaged." [34 CFR 682.410(b)(6)(vi)]

The Authority recently implemented a new debt recovery software system: The new system was apparently not configured to address this requirement. The Authority would not be in compliance with federal regulations.

**Recommendation**

The system should be modified so that the required letters are sent out automatically on a timely basis.

**Management's Response and Corrective Action Plan**

*Management has stated that this has already been done.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-KHEAA2-66: The Kentucky Higher Education Assistance Authority  
Should Be Suborgated To The Federal Government In A Timely Manner**

---

State Agency: Kentucky Higher Education Assistance Authority  
Federal Program: CFDA 84.032 - Federal Family Education Loans  
Federal Agency: U.S. Department of Education  
Pass-Through Agency: Not Applicable  
Compliance: Reporting  
Amount of Questioned Costs: \$0

Federal regulations require that loans with no activity for five years be suborgated to the federal government unless certain conditions are met. We noted that loans with a principal balance of approximately \$292,000 had been kept by the Authority past the time when we believe they should have been turned over to the federal government.

The computer software that the Authority uses is designed to identify loans that meet the requirement to be suborgated to the federal government. The Authority's Default Management Branch has been working with their office of technology to modify the programming so that all applicable loans are identified. To date, they have not been successful.

The Authority may not be in compliance with federal regulations in this area.

**Recommendation**

Procedures should be put in place to identify all of the loans that are required to be turned over to the federal government.



**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-KHESLC1-67: The Kentucky Higher Education Student Loan Corporation Should Closely Monitor Data Transmissions**

---

State Agency: Kentucky Higher Education Assistance Authority  
Federal Program: CFDA 84.032 - Federal Family Education Loans  
Federal Agency: U.S. Department of Education  
Pass-Through Agency: Not Applicable  
Compliance: Reporting  
Amount of Questioned Costs: \$43,000

The interest and special allowance benefits related to the affected loans is approximately \$43,000. Of this amount, approximately \$35,000 related to loans owned by the Corporation and \$8,000 related to loans serviced on behalf of customers. Management has informed us that adjustments related to these loans will be submitted through the Department of Education's Lender Reporting System ("LaRS") filing for the quarter ended September 30, 2006.

The Corporation utilizes the National Student Clearinghouse ("NSC") in order to obtain data regarding whether various borrowers have separated from school. Leaving school is the event that causes a student loan to enter repayment status after the grace period. In two instances, data transmissions from the NSC began but apparently were interrupted prior to completion. In those cases, all of the data from the NSC did not get fully transmitted to the Corporation.

Management determined that the data transfer began, but did not have procedures in place to insure that it was completed. They did not contemplate a problem related to the interruption of the data transmission.

In the last three years, two of 256 data transmissions from the NSC were determined to be interrupted. This resulted in several loans not being placed in a repayment status on a timely basis. The loans involved were less than one fifth of one percent of the entire population of in-school/in-grace loans.

**Recommendation**

We recommend that procedures be put in place to insure that all data transmissions from NSC (or any key data source) that are initiated are also completed.

**Management's Response and Corrective Action Plan**

*Management has made immediate changes to comply with the recommendation.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-TC12-68: The Transportation Cabinet Should Improve Procedures  
To Ensure Federal Reports Are Prepared Accurately**

---

State Agency: Transportation Cabinet  
Federal Program: 20.205 - Highway Planning and Construction  
Federal Agency: U.S. Department of Transportation  
Pass-Through Agency: Not Applicable  
Compliance Area: Reporting  
Amount of Questioned Cost: \$0

The Kentucky Transportation Cabinet (KYTC) is responsible for submitting an “Office of Real Estate Services Annual Program Statistics Report” to the regional Federal Highway Administration (FHWA) each federal fiscal year. We tested the FY06 report and found that some of the amounts recorded within the report were inaccurate. We noted the following discrepancies:

- Data appearing in the MRDB reports was not included on the Agency’s monthly reconciliations
- Items were being grouped under one category instead of being accounted for in multiple categories, as it was necessary for Relocation.
- Improper use of templates for posting transactions
- Items were left off or added twice
- Items paid out of an incorrect Activity Code
- Information included in reports that did not belong

The report inaccurately under-reported the amounts falling under the acquisition categories (Tables B and C) by \$987,185.35, and under reported the amounts falling into the relocation categories (Tables D, E, and F) by \$28,162.62.

Similar problems were noted in the prior year.

The “Office of Real Estate Services Annual Program Statistics Report” is not being properly reviewed. We are aware that the Division of Right of Way and Utilities have improved their record keeping procedures by recording reporting categories in the accounting system for acquisition and relocation expenditures. The division has also improved their record keeping, by maintaining monthly spreadsheets with information related to the statistical report. However, management is not performing an in-depth review of these spreadsheets or this report. Without proper management oversight there is a risk of inaccurate data being reported.

According to 49 CFR 24 Appendix B - Statistical Report Form, “Report Coverage - This report covers all relocation and real property acquisition activities under a Federal or federally assisted project or program subject to the provisions of the Uniform Act.” All

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-TC12-68: The Transportation Cabinet Should Improve Procedures  
To Ensure Federal Reports Are Prepared Accurately (Continued)**

---

information and amounts contained in the FHWA Statistics Report should be accurate and trace to supporting documentation on file at the agency.

**Recommendation**

We recommend that the Division of Right of Way and Utilities improve the policies and procedures for Statistical Reporting. Many of the issues occurred during the three-month eMARS period. The Division of Right of Way and Utilities need to adjust their procedures to accommodate eMARS.

The Division of Right of Way and Utilities should also provide more management oversight on Statistical Reporting to prevent inaccurate data from being reported to the FHWA.

**Management's Response and Corrective Action Plan**

*Due to the implementation of eMARS it was difficult to be able to query the system like we had done previously with PD. However after reviewing the eMARS system we were able to determine where in the pay documents to put our reporting categories to be able to pull the information we query. After reviewing the conditions of noncompliance; we have discussed implementing the following actions for correction: (1) Review the reporting categories to reflect a more specific transaction, which should prevent charges being reported to the wrong reporting category. (2) Review of the report (acquisition and relocation) every month by a Right of Way Program Specialist to ensure accuracy. (3) Perform a closer review of the end of the month transactions to better ensure that the costs are being reported under the proper reporting categories and activity codes. Now that we have a better understanding of eMARS and the location of reporting categories we plan to request a review of our reporting system with Information Technology to discuss a more accurate system for record keeping and reporting of our acquisition and relocation expenditures.*

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-TC13-69: The Transportation Cabinet Should Improve Procedures To Ensure The Correct Certification Letter For Materials Is Submitted To The Federal Highway Authority**

---

State Agency: Transportation Cabinet  
Federal Program: 20.205 - Highway Planning and Construction  
Federal Agency: U.S. Department of Transportation  
Pass-Through Agency: Not Applicable  
Compliance Area: Special Tests and Provisions  
Amount of Questioned Cost: \$0

During the FY2006 materials audit, we tested 45 items and found two instances of non-compliance with the Department of Transportation Federal Highway Administration (FHWA) Code of Federal Regulations, regarding the "Letter of Certification by State Engineer". One instance was the failure to submit a materials certification to the FHWA as required by 23 CFR 637.207. The second instance was a failure to notify the FHWA of any materials that had exceptions to the plans and specifications as required by 23 CFR 637 Appendix A to subpart B.

The correct certification letter (Form TC64-1) for completed IAS projects was not used; instead, the incorrect certification letter (Form TC64-5) was used for this project. Use of the wrong form caused the failure to submit a materials certification to the FHWA.

There was an oversight during the preparation of the Letter of Certification sent to the FHWA at the time of certification. The failing IAS sample test should have been noted on the certification letter to the FHWA.

Federal Highway Administration 23 CFR 637.207 (Construction Inspection and Approval) states, "The preparation of materials certification, conforming in substance to Appendix A of this subpart, shall be submitted to the FHWA Division Administrator for each construction project which is subject to FHWA construction oversight activities."

Federal Highway Administration 23 CFR 637 Appendix A to subpart B - Guide Letter of Certification by State Engineer, provides an example of the letter to be submitted by the State Engineer. If exceptions have occurred, the letter must state, "Exceptions to the plans and specifications are explained on the back hereof (or on attached sheet)."

**COMMONWEALTH OF KENTUCKY  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

**FINDING 06-TC13-69: The Transportation Cabinet Should Improve Procedures To Ensure The Correct Certification Letter For Materials Is Submitted To The Federal Highway Authority (Continued)**

---

**Recommendation**

We recommend that the Division of Materials improve their review procedures to ensure that required projects submit a materials certification letter to the FHWA. The review procedures should include:

1. Identifying Federal Projects at an early stage to ensure that a materials certification letter is submitted to the FHWA.
2. Review of the project file to ensure that the proper materials certification letter has been completed and has been submitted to the FHWA.
3. Review of the materials certification letter to make sure that it contains the all the information required by the FHWA. Which would include reviewing to ensure that an explanation of exceptions to the plans and specifications is included when needed.

**Management's Response and Corrective Action Plan**

*Both instances of non-compliance were due to oversight and immediately corrected. The Division of Materials has review procedures in place that are in agreement with the recommendations. These procedures have been reviewed and every effort will be made to prevent a reoccurrence. The Division of Materials is ready to go into production with a new software system for materials management, which will substantially improve the tracking process.*

**SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS**

**COMMONWEALTH OF KENTUCKY  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
FOR THE YEAR ENDED JUNE 30, 2006**

<b>Fiscal Year</b>	<b>Finding Number</b>	<b>Finding</b>	<b>CFDA Number</b>	<b>Questioned Costs</b>	<b>Comments</b>
<b><u>Reportable Conditions</u></b>					
<i>(1) Audit findings that have been fully corrected:</i>					
FY 05	05-AGR2-41	The Department Of Agriculture Should Develop Procedures Over School Site Monitoring To Ensure Compliance With Federal Regulations	10.550	0	Resolved during FY 06
FY 05	05-AGR3-42	The Department Of Agriculture Should Monitor The Local Agencies And Storage Facilities That Distribute USDA Commodity Foods Under The Commodity Supplemental Food Program	10.565	0	Resolved during FY 06
FY 05	05-CHFS2-2	The Cabinet of Health of Family Services' Password Policy Should Be Consistently Applied To All Local Area Network Machines	NA	0	Due to improvements, this finding is downgraded to an other matter for FY 06. This finding is no longer required to be reported under <i>Government Auditing Standards</i> .
FY 05	05-CHFS3-3	The Cabinet For Health And Family Services Should Develop And Implement Adequate System Development Life Cycles Policies And Procedures Governing Controls For Program Development And Modifications	NA	0	Resolved during FY 06
FY 05	05-CHFS4-4	The Cabinet For Health And Family Services Should Develop Automated Analysis Procedures To Identify High Risk Transactions Within Benefit Programs	10.561 93.558 93.778	0	Due to improvements, this finding is downgraded to an other matter for FY 06. This finding is no longer required to be reported under <i>Government Auditing Standards</i> .
FY 05	05-CHFS5-5	The Cabinet For Health And Family Services Should Review System Edits Related To Program Limitations	93.558	0	Due to improvements, this finding is downgraded to an other matter for FY 06. This finding is no longer required to be reported under <i>Government Auditing Standards</i> .

**COMMONWEALTH OF KENTUCKY  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

<b>Fiscal Year</b>	<b>Finding Number</b>	<b>Finding</b>	<b>CFDA Number</b>	<b>Questioned Costs</b>	<b>Comments</b>
<b><u>Reportable Conditions (Continued)</u></b>					
<i>(1) Audit findings that have been fully corrected: (Continued)</i>					
FY 05	05-CHFS6-6	The Cabinet For Health And Family Services Should Implement Controls To Ensure Proper Preparation And Review Of Closing Package Forms	NA	0	Due to improvements, this finding is downgraded to an other matter for FY 06. This finding is no longer required to be reported under <i>Government Auditing Standards</i> .
FY 05	05-CHFS14-45	The Cabinet For Health And Family Services Did Not Adequately Monitor Subrecipients Through the Desk Review Process	93.563 93.575	0	Due to improvements, this finding is downgraded to an other matter for FY 06. This finding is no longer required to be reported under <i>Government Auditing Standards</i> .
FY 05	05-CHFS15-46	The Cabinet For Health And Family Services Did Not Implement The Corrective Action Plan For Subrecipient Monitoring	93.563 93.575	0	Due to improvements, this finding is downgraded to an other matter for FY 06. This finding is no longer required to be reported under <i>Government Auditing Standards</i> .
FY 05	05-CPE1-8	The Council On Postsecondary Education Should Verify Expenditures Under An MOA To Be Within The Limits Specified Under the MOA	NA	0	Resolved during FY 06
FY 05	05-CPE2-47	The Council On Postsecondary Education Should Improve Subrecipient Monitoring Procedures	84.002	0	Resolved during FY 06
FY 05	05-DFWR3-50	The Department Of Fish And Wildlife Resources Should Continue Efforts To Have The General Assembly Remove KRS 150.150 Language From KRS 48.315	NA	0	Resolved during FY 06
FY 05	05-DMA2-51	The Department Of Military Affairs Should Develop An Internal Control System To Comply With OMB Circular A-133 Compliance Requirements	97.004	0	Resolved during FY 06



**COMMONWEALTH OF KENTUCKY  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

<b>Fiscal Year</b>	<b>Finding Number</b>	<b>Finding</b>	<b>CFDA Number</b>	<b>Questioned Costs</b>	<b>Comments</b>
<b><u>Reportable Conditions (Continued)</u></b>					
<i>(1) Audit findings that have been fully corrected: (Continued)</i>					
FY 05	05-DMA3-52	The Department Of Military Affairs Should Continue To Implement The Procedures Established To Fully Comply With OMB A-133 And Develop Procedures To Ensure Personnel Complete The Entire Monitoring Tool	97.036	0	Resolved during FY 06
FY 05	05-DMA4-53	The Department Of Military Affairs Should Adhere To Policies Instituted For Oversight Of The Installation Management Fund Accounts	12.401	0	Due to improvements, this finding is downgraded to an other matter for FY 06. This finding is no longer required to be reported under <i>Government Auditing Standards</i> .
FY 05	05-DMA5-54	The Department Of Military Affairs Should Provide The USPFO A Written Report Of Unliquidated Claims And Undisbursed Obligations Within Ninety Days After The End Of Grants	12.401	0	Resolved during FY 06
FY 05	05-DMA6-55	The Department Of Military Affairs Should Establish Procedures To Ensure SF-269 Quarterly Reports Are Accurate	97.036	0	Resolved during FY 06
FY 05	05-DMA8-57	The Department Of Military Affairs Should Review Employee Approval Authorities	12.401	0	Due to improvements, this finding is downgraded to an other matter for FY 06. This finding is no longer required to be reported under <i>Government Auditing Standards</i> .
FY 05	05-DMA9-58	The Department Of Military Affairs Should Require Applicants File Extension Requests Before The Initial Deadlines Recorded On Project Worksheets	97.036	0	Resolved during FY 06

**COMMONWEALTH OF KENTUCKY  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

<b>Fiscal Year</b>	<b>Finding Number</b>	<b>Finding</b>	<b>CFDA Number</b>	<b>Questioned Costs</b>	<b>Comments</b>
<b><u>Reportable Conditions (Continued)</u></b>					
<i>(1) Audit findings that have been fully corrected: (Continued)</i>					
FY 05	05-DOC1-9	The Department of Corrections Should Monitor Contract Expenditures and Maintain Documentation as Required by the Finance and Administration Cabinet	NA	0	Resolved during FY 06
FY 05	05-DOC2-10	The Department of Corrections Should Strengthen Existing Procurement Card Internal Controls	NA	0	Resolved during FY 06
FY 05	05-DWI12-60	The Department For Workforce Investment Should Ensure Adjustments And Corrections Are Entered Within 90 Days After All Funds Have Been Expended Or The Period Of Availability Has Expired	17.258 17.259 17.260	\$565,437	Due to improvements, this finding is downgraded to an other matter for FY 06. This finding is no longer required to be reported under <i>Government Auditing Standards</i> .
FY 05	05-DWI13-61	The Office Of Employment And Training Should Improve The Policy And Procedure Manual For the Financial Reporting Process And Implement A Policy For Secondary Review Of Financial Status Reports	17.258 17.259 17.260	0	Resolved during FY 06
FY 05	05-DWI14-62	The Department For Workforce Investment Materially Misrepresented Its Corrective Action Plan To Agree And Reconcile Drawdowns	17.258 17.259 17.260	0	Resolved during FY 06
FY 05	05-DWI15-63	The Department For Workforce Investment Materially Misrepresented Its Corrective Action Plan To Perform A Secondary Review Of Financial Status Reports	17.258 17.259 17.260	0	Resolved during FY 06
FY 05	05-FAC3-17	The Finance And Administration Cabinet Should Ensure That Securities Lending Assets, Liabilities, Revenues, And Expenditures Are Reported In Funds Sharing The Risk Of Loss	NA	0	Resolved during FY 06

**COMMONWEALTH OF KENTUCKY  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

<b>Fiscal Year</b>	<b>Finding Number</b>	<b>Finding</b>	<b>CFDA Number</b>	<b>Questioned Costs</b>	<b>Comments</b>
<b><u>Reportable Conditions (Continued)</u></b>					
<i>(1) Audit findings that have been fully corrected: (Continued)</i>					
FY 05	05-FAC4-18	The Finance And Administration Cabinet Should Perform A Periodic Review Of Transactions Approved By The "Superusers" And Agency MARS Administrators	NA	0	Resolved during FY 06
FY 05	05-FAC7-21	The Finance and Administration Cabinet Should Ensure Procurements Are Made In Accordance With Finance and Administration Cabinet Policies And Procedures And Ensure That Vendor Submissions Are Scored Correctly	NA	0	Resolved during FY 06
FY 05	05-FAC8-22	The Finance And Administration Cabinet Should Review And Document Potential Conflicts Of Interest Prior To Awarding Contracts	NA	0	Resolved during FY 06
FY 05	05-FAC9-23	The Finance And Administration Cabinet Should Develop Procedures To Ensure All Supporting Documentation Is Retained	NA	0	Resolved during FY 06
FY 05	05-FAC10-24	The Finance And Administration Cabinet Should Permanently Remove The University Of Louisville Land Contract Journal Voucher Recorded Annually For CAFR Compilation	NA	0	Resolved during FY 06
FY 05	05-KOHS2-69	The Kentucky Office Of Homeland Security Should Develop And Implement Procedures For Documenting The Evaluation Of All Grant Applications And Final Award Decisions	97.004	0	Resolved during FY 06
FY 05	05-KOHS3-70	The Kentucky Office Of Homeland Security Should Develop And Document A Plan For Administrative Expenditures	97.004	0	Resolved during FY 06
FY 05	05-JUST2-64	The Justice Cabinet Should Have A Documented Method In Place For Allocating Indirect Charges To Their Grant Programs	16.575 16.579 16.588	\$372,757	Resolved during FY 06

**COMMONWEALTH OF KENTUCKY  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

<b>Fiscal Year</b>	<b>Finding Number</b>	<b>Finding</b>	<b>CFDA Number</b>	<b>Questioned Costs</b>	<b>Comments</b>
<b><u>Reportable Conditions (Continued)</u></b>					
<i>(1) Audit findings that have been fully corrected: (Continued)</i>					
FY 05	05-JUST4-66	The Justice Cabinet Should Agree Federal Expenditure Reports To MARS	16.575 16.579 16.588		Resolved during FY 06
FY 05	05-JUST5-67	The Justice Cabinet Should Not Supplant State Funds With Federal Funds	16.579	\$34,435	Resolved during FY 06
FY 05	05-JUST6-68	The Justice Cabinet Should Ensure That All Equipment Is Properly Entered Into MARS	16.579	0	Resolved during FY 06
FY 05	05-PARKS1-25	The Department of Parks Should Ensure Compliance With Procurement Card Policies	NA	0	Resolved during FY 06
FY 05	05-PARKS2-26	The Department of Parks Should Strengthen Controls Over Timecards/Timesheets And Payroll Records	NA	0	Resolved during FY 06
FY 05	05-PERS1-27	The Personnel Cabinet Should Strengthen Controls To Minimize The Potential Abuse Of Voter Leave	NA	0	Resolved during FY 06
FY 05	05-REV2-29	The Department Of Revenue Should Ensure That All Penalties Are Distinctively Reported Into The Revenue's System	NA	0	Resolved during FY 06
FY 05	05-REV3-30	The Department Of Revenue Should Strengthen Physical Securities	NA	0	Due to improvements, this finding is downgraded to an other matter for FY 06. This finding is no longer required to be reported under <i>Government Auditing Standards</i> .
FY 05	05-TC1-31	The Transportation Cabinet Should Strengthen Logical Security Controls Over The Transportation Information Payroll System	NA	0	Resolved during FY 06
FY 05	05-TC3-33	The Transportation Cabinet Should Implement Procedures To Ensure An Accurate Conversion Of Data To New Systems	NA	0	Resolved during FY 06

**COMMONWEALTH OF KENTUCKY  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

<b>Fiscal Year</b>	<b>Finding Number</b>	<b>Finding</b>	<b>CFDA Number</b>	<b>Questioned Costs</b>	<b>Comments</b>
<b><u>Reportable Conditions (Continued)</u></b>					
<i>(1) Audit findings that have been fully corrected: (Continued)</i>					
FY 05	05-TC4-34	The Transportation Cabinet Should Implement Procedures To Ensure The Integrity Of The Highway Information System Database	NA	0	Resolved during FY 06
FY 05	05-TC5-35	The Transportation Cabinet Should Improve Data Retention Practices	NA	0	Resolved during FY 06
FY 05	05-TC6-36	The Transportation Cabinet Should Improve Audit Trail Procedures For Database Actions	NA	0	Resolved during FY 06
FY 05	05-TC7-37	The Transportation Cabinet Should Adhere To State Law Regarding Voting Leave And Follow Up On Possible Violations	NA	0	Resolved during FY 06
FY 04	04-CFC1-1	The Cabinet For Families And Children Password Policy Should Be Consistently Applied To All Local Area Network Servers	NA	0	Due to improvements, this finding is downgraded to an other matter for FY 06. This finding is no longer required to be reported under <i>Government Auditing Standards</i> .
FY 04	04-CHS2-24	The Cabinet for Health Services Should Improve Efforts In Monitoring Subrecipient Activity	93.283	0	Due to improvements, this finding is downgraded to an other matter for FY 06. This finding is no longer required to be reported under <i>Government Auditing Standards</i> .
FY 04	04-CWD12-28	The Department For Training And Reemployment Should Process Journal Vouchers Timely	NA	0	Due to improvements, this finding is downgraded to an other matter for FY 06. This finding is no longer required to be reported under <i>Government Auditing Standards</i> .

**COMMONWEALTH OF KENTUCKY  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

<b>Fiscal Year</b>	<b>Finding Number</b>	<b>Finding</b>	<b>CFDA Number</b>	<b>Questioned Costs</b>	<b>Comments</b>
<b><u>Reportable Conditions (Continued)</u></b>					
<i>(1) Audit findings that have been fully corrected: (Continued)</i>					
FY 04	04-DFWR2-30	The Department Of Fish And Wildlife Resources Should Consider Requesting The General Assembly To Adopt 50 CFR 80.3-80.4 Into State Law	15.605 15.611	0	Resolved during FY 06
FY04	04-DMA2-33	The Department Of Military Affairs Should Implement Internal Control Procedures To Comply With NGR 5-1/ANGI 63/101 Relating To Program Income For The National Guard Program	12.401	0	Resolved during FY 06
FY 04	04-JUST1-37	The Justice Cabinet Should Implement And Follow An Approved Indirect Cost Allocation Plan	16.575 16.579 16.588	\$363,063	Resolved during FY 06
FY 04	04-JUST4-40	The Justice Cabinet Should Implement Procedures to Ensure All Grant Funds Are Expended In Accordance With Federal Guidelines	16.575 16.579 16.588	0	Resolved during FY 06
FY 04	04-JUST5-41	The Justice Cabinet Should Not Supplant State Funds With Federal Funds	16.579	\$30,413	Resolved during FY 06
FY04	04-PARKS1-11	The Department Of Parks Should Improve Controls Over Timesheets And Payroll Reports	NA	0	Resolved during FY 06
FY 04	04-TC2-14	The Transportation Cabinet Should Implement Procedures To Ensure An Accurate Conversion Of Data To New Systems	NA	0	Resolved during FY 06
FY 04	04-TC3-15	The Transportation Cabinet Should Implement Procedures To Ensure The Integrity Of The Highway Information System Database	NA	0	Resolved during FY 06
FY 04	04-TC4-16	The Transportation Cabinet Should Improve Data Retention Practices	NA	0	Resolved during FY 06
FY 04	04-TC5-17	The Transportation Cabinet Should Improve Audit Trail Procedures For Database Actions	NA	0	Resolved during FY 06

**COMMONWEALTH OF KENTUCKY  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

<b>Fiscal Year</b>	<b>Finding Number</b>	<b>Finding</b>	<b>CFDA Number</b>	<b>Questioned Costs</b>	<b>Comments</b>
<b><u>Reportable Conditions (Continued)</u></b>					
<b><i>(1) Audit findings that have been fully corrected: (Continued)</i></b>					
FY03	03-CWD11-41	The Department For Training And Reemployment Should Implement Formal Procedures To Ensure Accurate Federal Reporting	NA	0	Resolved during FY 06
FY03	03-JUST1-32	The Justice Cabinet Should Either Develop An Indirect Cost Allocation Plan And Submit It To The Cognizant Federal Agency For Approval Or Stop Charging Indirect Costs To The Federal Government	16.575 16.579 16.588	\$46,774	Resolved during FY 06
FY03	03-JUST4-35	The Justice Cabinet Should Ensure Information On The Quarterly Financial Status Report Is Reliable	16.575 16.579 16.588	0	Resolved during FY 06
FY02	02-JUST4-42	The Justice Cabinet Should Prepare Quarterly Financial Status Reports That Are Supported By Adequate Documentation	16.575 16.579 16.588	0	Resolved during FY 06
<b><i>(2) Audit findings not corrected or partially corrected:</i></b>					
FY 05	05-CHFS1-1	The Cabinet For Health And Family Services Should Strengthen The Security Of System Accounts	NA	0	See 06-CHFS1-1
FY 05	05-CHFS7-7	The Cabinet For Health And Family Services Should Obtain A SAS 70 Audit Report For Tier Technologies, Inc	NA	0	See 06-CHFS6-6
FY 05	05-CHFS12-43	The Cabinet For Health And Family Services Should Follow Documented Policies And Procedures And Maintain Adequate Records To Ensure Payments Are Made For Services To Eligible Recipients	93.558	\$29,820	See 06-CHFS21-47
FY 05	05-CHFS13-44	The Cabinet For Health And Family Services Should Improve Child Support Enforcement Performance To Ensure Children Receive Proper Financial Support	93.563	0	See 06-CHFS22-48

**COMMONWEALTH OF KENTUCKY  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

<b>Fiscal Year</b>	<b>Finding Number</b>	<b>Finding</b>	<b>CFDA Number</b>	<b>Questioned Costs</b>	<b>Comments</b>
<b><u>Reportable Conditions (Continued)</u></b>					
<b><i>(2) Audit findings not corrected or partially corrected: (Continued)</i></b>					
FY 05	05-DFWR1-48	The Department Of Fish And Wildlife Resources Should Develop Procedures Over Cash Drawdowns Within A Reasonable Time Frame	15.605 15.611	0	See 06-DFWR4-55
FY 05	05-DFWR2-49	The Department Of Fish And Wildlife Resources Should Develop And Implement An Accounting Policy Requiring The Retention Of Supporting Documentation For All Cash And Check Receipts	15.605 15.611	0	See 06-DFWR6-57
FY 05	05-DMA7-56	The Department Of Military Affairs Should Reimburse The Federal Government For Questioned Costs And Request Reimbursement Only For Expenditures That Have Adequate Supporting Documentation	12.401	\$40,188	Corrective action plan implemented, but questioned cost has not been resolved.
FY 05	05-DWI1-11	The Department Of Workforce Investment Should Strengthen Controls To Improve Reporting Of Employer Accounts	NA	0	See 06-DWI1-11
FY 05	05-DWI2-12	The Department Of Workforce Investment Should Develop Procedures To Determine And Document Estimates To Ensure Consistency	NA	0	See 06-DWI2-12
FY 05	05-DWI3-13	The Department Of Workforce Investment Should Declare Old Accounts Uncollectible And Write Them Off In A Timely Manner	NA	0	See 06-DWI3-13
FY 05	05-DWI4-14	The Department Of Workforce Investment Should Review The Closing Package Before Submission To The Finance And Administration Cabinet	NA	0	See 06-DWI4-14
FY 05	05-DWI11-59	Information Provided To The Department Of Labor Should Agree With State Accounting Data	84.048	0	See 06-DWI9-62



**COMMONWEALTH OF KENTUCKY  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

<b>Fiscal Year</b>	<b>Finding Number</b>	<b>Finding</b>	<b>CFDA Number</b>	<b>Questioned Costs</b>	<b>Comments</b>
<b><u>Reportable Conditions (Continued)</u></b>					
<b><i>(2) Audit findings not corrected or partially corrected: (Continued)</i></b>					
FY 05	05-FAC1-15	The Finance And Administration Cabinet Should Formalize And Consistently Apply The Program Modification Process For The Commonwealth's Cash And Investments System	NA	0	See 06-FAC8-28
FY 05	05-FAC2-16	The Finance And Administration Cabinet Should Strengthen Logical Security Procedures Surrounding The Complete Asset Management, Reporting, And Accounting System	NA	0	See 06-FAC7-27
FY 05	05-FAC5-19	The Governor's Office For Policy And Management Should Provide Complete And Accurate Guidance Regarding Investment Income	NA	0	See 06-FAC4-24
FY 05	05-FAC6-20	The Office Of Financial Management Should Develop Procedures To Review Statutory References	NA	0	See 06-FAC4-24
FY 05	05-JUST3-65	The Justice Cabinet Should Implement Procedures To Ensure Consistent Enforcement And Documentation Of Subrecipient Monitoring Requirements	16.575 16.579 16.588	0	See 06-JUST1-63 and 06-JUST2-64
FY 05	05-REV1-28	Electronic Payments To The Clearing Account Are Not Accurately Posted In Revenue's System, And No Corrections Of Those Errors Are Being Made	NA	0	See 06-REV1-36
FY 05	05-TC2-32	The Transportation Cabinet Should Improve Inventory Procedures For Maintenance Materials	NA	0	See 06-TC3-43
FY 05	05-TC15-71	The Transportation Cabinet Should Ensure All Federal Expenditures Are Allowable	20.205 20.600	\$559,816	Corrective action plan implemented, but questioned cost has not been resolved.

**COMMONWEALTH OF KENTUCKY  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

<b>Fiscal Year</b>	<b>Finding Number</b>	<b>Finding</b>	<b>CFDA Number</b>	<b>Questioned Costs</b>	<b>Comments</b>
<b><u>Reportable Conditions (Continued)</u></b>					
<b><i>(2) Audit findings not corrected or partially corrected: (Continued)</i></b>					
FY 05	05-TC16-72	The Transportation Cabinet Should Improve Procedures To Ensure Federal Reports Are Prepared Accurately	20.205	0	See 06-TC12-68
FY 04	04-CFC2-2	The Cabinet For Families And Children Should Ensure All Inactive Accounts Are Eliminated And That All Account Names Are Ambiguous	NA	0	See 06-CHFS1-1
FY 04	04-CFC6-18	The Cabinet For Families And Children Should Maintain Case File Records That Include Client Applications, Recertifications, And Records Of Eligibility Determinations	93.558	\$18,224	See 06-CHFS21-47
FY 04	04-CFC7-19	The Cabinet For Families And Children Should Maintain Adequate Records To Ensure Payments Are Made For Approved And Allowable Goods And Services To Eligible Recipients	93.558	\$16,774	See 06-CHFS21-47
FY 04	04-CFC8-20	The Cabinet For Families And Children Should Only Issue Work Incentive Payments To Eligible Individuals And Should Request And Maintain Adequate Documentation Of The Eligibility Determinations	93.558	\$1,040	See 06-CHFS21-47
FY 04	04-CFC10-22	The Cabinet For Families And Children Should Improve Child Support Enforcement Performance To Ensure Children Receive Proper Financial Support	93.563	0	See 06-CHFS22-48

**COMMONWEALTH OF KENTUCKY  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

<b>Fiscal Year</b>	<b>Finding Number</b>	<b>Finding</b>	<b>CFDA Number</b>	<b>Questioned Costs</b>	<b>Comments</b>
<b><u>Reportable Conditions (Continued)</u></b>					
<b><i>(2) Audit findings not corrected or partially corrected: (Continued)</i></b>					
FY04	04-CWD1-3	The Division Of Unemployment Insurance Should Strengthen Controls Over Systematic Programs To Ensure Accurate Information Is Available For Closing Package Reporting	NA	0	See 06-DWI1-11
FY04	04-CWD2-4	The Division Of Unemployment Insurance Should Implement Controls To Ensure Proper Review Of Closing Package Forms Submitted To Finance And Administration Cabinet	NA	0	See 06-DWI4-14
FY04	04-FAC4-9	The Finance And Administration Cabinet Should Formalize And Consistently Apply The Program Modification Process For The Commonwealth's Cash And Investment System	NA	0	See 06-FAC8-28
FY04	04-FAC5-10	The Finance And Administration Cabinet Should Strengthen Logical Security Procedures Surrounding The Complete Assets Management Reporting and Accounting System	NA	0	See 06-FAC7-27
FY04	04-JUST2-38	The Justice Cabinet Should Provide Sufficient Documentation Of Subrecipient Monitoring Activities	16.575 16.579 16.588	0	See 06-JUST1-63 and 06-JUST2-64
FY 04	04-TC1-13	The Transportation Cabinet Should Improve Inventory Procedures For Maintenance Materials	NA	0	See 06-TC3-43
FY 04	04-TC11-45	The Transportation Cabinet Should Improve Procedures To Ensure Federal Reports Are Prepared Accurately	20.205	0	See 06-TC12-68

***(3) Corrective action taken is significantly different from corrective action previously reported:***

No findings for this section.

**COMMONWEALTH OF KENTUCKY  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

<b>Fiscal Year</b>	<b>Finding Number</b>	<b>Finding</b>	<b>CFDA Number</b>	<b>Questioned Costs</b>	<b>Comments</b>
<b><u>Reportable Conditions (Continued)</u></b>					
<i>(4) Audit finding is no longer valid or does not warrant further action:</i>					
FY 03	03-CFC1-1	The Cabinet For Families And Children Password Policy Should Be Consistently Applied To All Local Area Network Servers	NA	0	Two or more years have passed since the audit report in which this finding was submitted to the Federal Clearinghouse. A management decision has not been issued.
FY 03	03-CFC8-30	The Cabinet For Families And Children Should Maintain Adequate Records To Ensure That Payments Are Made For Approved And Allowable Goods And Services	93.558	\$5,791	Two or more years have passed since the audit report in which this finding was submitted to the Federal Clearinghouse. The Federal Agency is not currently following up on this audit finding. A management decision has not been issued.
FY03	03-CWD2-26	The Division Of Unemployment Insurance Should Enhance Controls To Ensure Proper Reporting Of The Closing Package	NA	0	Two or more years have passed since the audit report in which this finding was submitted to the Federal Clearinghouse. A management decision has not been issued.
FY03	03-FAC6-8	The Finance And Administration Cabinet Should Develop And Apply Formal System Development Life Cycle Procedures For The Commonwealth's Cash and Investment Statistical Analysis System Programs	NA	0	Two or more years have passed since the audit report in which this finding was submitted to the Federal Clearinghouse. A management decision has not been issued.

**COMMONWEALTH OF KENTUCKY  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

<b>Fiscal Year</b>	<b>Finding Number</b>	<b>Finding</b>	<b>CFDA Number</b>	<b>Questioned Costs</b>	<b>Comments</b>
<b><u>Reportable Conditions (Continued)</u></b>					
<i>(4) Audit finding is no longer valid or does not warrant further action: (Continued)</i>					
FY03	03-FAC7-9	The Office Of Financial Management Should Improve Segregation of Duty Controls	NA	0	Two or more years have passed since the audit report in which this finding was submitted to the Federal Clearinghouse. A management decision has not been issued.
FY03	03-JUST2-33	The Justice Cabinet Should Follow Established Subrecipient Monitoring Policies And Procedures To Ensure Subrecipient Monitoring Is Properly Performed And Documented	16.575 16.579 16.588	0	Two or more years have passed since the audit report in which this finding was submitted to the Federal Clearinghouse. The Federal Agency is not currently following up on this audit finding. A management decision has not been issued.
FY03	03-MIL2-37	The Department of Military Affairs Should Implement A System To Properly Monitor Subrecipient Activities To Comply With OMB Circular A-133 Compliance Requirements	97.036	0	Two or more years have passed since the audit report in which this finding was submitted to the Federal Clearinghouse. The Federal Agency is not currently following up on this audit finding. A management decision has not been issued.
FY 03	03-TC3-20	The Transportation Cabinet Should Implement Procedures To Ensure An Accurate Conversion of Data To New Systems	NA	0	Two or more years have passed since the audit report in which this finding was submitted to the Federal Clearinghouse. A management decision has not been issued.

**COMMONWEALTH OF KENTUCKY  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

<b>Fiscal Year</b>	<b>Finding Number</b>	<b>Finding</b>	<b>CFDA Number</b>	<b>Questioned Costs</b>	<b>Comments</b>
<b><u>Reportable Conditions (Continued)</u></b>					
<b><i>(4) Audit finding is no longer valid or does not warrant further action: (Continued)</i></b>					
FY 03	03-TC4-21	The Transportation Cabinet Should Implement Procedures To Ensure The Integrity Of The Highway Information System Database	NA	0	Two or more years have passed since the audit report in which this finding was submitted to the Federal Clearinghouse. A management decision has not been issued.
FY 03	03-TC5-22	The Transportation Cabinet Should Improve Data Retention Practices	NA	0	Two or more years have passed since the audit report in which this finding was submitted to the Federal Clearinghouse. A management decision has not been issued.
FY 03	03-TC6-23	The Transportation Cabinet Should Improve Audit Trail Procedures For Database Actions	NA	0	Two or more years have passed since the audit report in which this finding was submitted to the Federal Clearinghouse. A management decision has not been issued.
FY 03	03-TC12-39	The Transportation Cabinet Should Maintain Documentation That Supports Figures Reported In the Annual Federal Highway Administration Statistics Report.	20.205	0	Two or more years have passed since the audit report in which this finding was submitted to the Federal Clearinghouse. The Federal Agency is not currently following up on this audit finding. A management decision has not been issued.

**COMMONWEALTH OF KENTUCKY  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

<b>Fiscal Year</b>	<b>Finding Number</b>	<b>Finding</b>	<b>CFDA Number</b>	<b>Questioned Costs</b>	<b>Comments</b>
<b><u>Reportable Conditions (Continued)</u></b>					
<i>(4) Audit finding is no longer valid or does not warrant further action: (Continued)</i>					
FY 02	02-CFC2-3	The Cabinet For Families And Children Password Policy Should Be Consistently Applied To All Local Area Network Servers	NA	0	Two or more years have passed since the audit report in which this finding was submitted to the Federal Clearinghouse. A management decision has not been issued.
FY 02	02-CFC15-35	The Cabinet For Families And Children Should Maintain And Produce Records To Adequately Support Expenditures	93.558	0	Two or more years have passed since the audit report in which this finding was submitted to the Federal Clearinghouse. The Federal Agency is not currently following up on this audit finding. A management decision has not been issued.
FY02	02-FAC3-6	The Finance And Administration Cabinet Should Develop And Consistently Apply Formal Change Management Control Procedures For The Commonwealth's Cash And Investment Statistical Analysis System Programs	NA	0	Two or more years have passed since the audit report in which this finding was submitted to the Federal Clearinghouse. A management decision has not been issued.
FY02	02-FAC4-7	The Office Of Financial Management Should Improve Segregation Of Duty Controls	NA	0	Two or more years have passed since the audit report in which this finding was submitted to the Federal Clearinghouse. A management decision has not been issued.

**COMMONWEALTH OF KENTUCKY  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

<b>Fiscal Year</b>	<b>Finding Number</b>	<b>Finding</b>	<b>CFDA Number</b>	<b>Questioned Costs</b>	<b>Comments</b>
<b><u>Reportable Conditions (Continued)</u></b>					
<b><i>(4) Audit finding is no longer valid or does not warrant further action: (Continued)</i></b>					
FY02	02-JUST2-40	The Justice Cabinet Should Develop Written Subrecipient Monitoring Policies And Procedures To Ensure Subrecipient Monitoring Is Properly Performed And Documented	16.575 16.579 16.588	0	Two or more years have passed since the audit report in which this finding was submitted to the Federal Clearinghouse. The Federal Agency is not currently following up on this audit finding. A management decision has not been issued.
FY 02	02-MIL1-43	The Department Of Military Affairs Should Ensure Subrecipient Monitoring Is Properly Performed	97.036	0	Two or more years have passed since the audit report in which this finding was submitted to the Federal Clearinghouse. The Federal Agency is not currently following up on this audit finding. A management decision has not been issued.
FY 02	02-TC2-46	The Transportation Cabinet Should Develop Internal Controls To Ensure Accurate Presentation Of the Annual Federal Highway Administration Statistics Report	20.205	0	Two or more years have passed since the audit report in which this finding was submitted to the Federal Clearinghouse. The Federal Agency is not currently following up on this audit finding. A management decision has not been issued.
FY 02	02-TC3-47	The Transportation Cabinet Should Ensure The Annual Federal Highway Administration Report Is Compiled In Compliance With Federal Guidelines	20.205	0	Two or more years have passed since the audit report in which this finding was submitted to the Federal Clearinghouse. The Federal Agency is not currently following up on this audit finding. A management decision has not been issued.



**COMMONWEALTH OF KENTUCKY  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

<b>Fiscal Year</b>	<b>Finding Number</b>	<b>Finding</b>	<b>CFDA Number</b>	<b>Questioned Costs</b>	<b>Comments</b>
<b><u>Reportable Conditions (Continued)</u></b>					
<b><i>(4) Audit finding is no longer valid or does not warrant further action: (Continued)</i></b>					
FY 01	01-CFC1-1	The Cabinet For Families And Children Should Improve Local Area Network Server Security And Consistently Apply Policies To All Servers	NA	0	Two or more years have passed since the audit report in which this finding was submitted to the Federal Clearinghouse. A management decision has not been issued.
FY 01	01-CFC2-36	The Cabinet For Families And Children Should Maintain And Produce Records To Adequately Support Expenditures	93.558	0	Two or more years have passed since the audit report in which this finding was submitted to the Federal Clearinghouse. The Federal Agency is not currently following up on this audit finding. A management decision has not been issued.
FY01	01-FAC3-4	The Office Of Financial Management Should Improve Control Procedures Over Modifications To System Programs	NA	0	Two or more years have passed since the audit report in which this finding was submitted to the Federal Clearinghouse. A management decision has not been issued.
FY 01	01-MIL1-46	The Department Of Military Affairs Should Ensure Subrecipients Meet OMB Circular A-133 Audit Requirements	97.036	0	Two or more years have passed since the audit report in which this finding was submitted to the Federal Clearinghouse. The Federal Agency is not currently following up on this audit finding. A management decision has not been issued.

**COMMONWEALTH OF KENTUCKY  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

<b>Fiscal Year</b>	<b>Finding Number</b>	<b>Finding</b>	<b>CFDA Number</b>	<b>Questioned Costs</b>	<b>Comments</b>
<b><u>Reportable Conditions (Continued)</u></b>					
<b><i>(4) Audit finding is no longer valid or does not warrant further action: (Continued)</i></b>					
FY00	00-FAC-6	The Office Of Financial Management Should Improve Control Procedures Over Modifications To System Programs	NA	0	Two or more years have passed since the audit report in which this finding was submitted to the Federal Clearinghouse. A management decision has not been issued.
FY 97 FY 00 FY 02	97-Military Affairs-50	The Department Of Military Affairs Should Strengthen Procedures For Monitoring Subrecipients	97.036	0	Two or more years have passed since the audit report in which this finding was submitted to the Federal Clearinghouse. The Federal Agency is not currently following up on this audit finding. A management decision has not been issued.

**COMMONWEALTH OF KENTUCKY  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

<b>Fiscal Year</b>	<b>Finding Number</b>	<b>Finding</b>	<b>CFDA Number</b>	<b>Questioned Costs</b>	<b>Comments</b>
<b><u>Material Weaknesses/Noncompliances</u></b>					
<i>(1) Audit findings that have been fully corrected:</i>					
FY 05	05-FAC11-38	The Office of Financial Management Should Adhere To Generally Accepted Accounting Principles	NA	0	Due to improvements, this finding is downgraded to an other matter for FY 06. This finding is no longer required to be reported under <i>Government Auditing Standards</i> .
FY 05	05-FAC12-39	The Finance And Administration Cabinet Should Develop Procedures To Ensure Proper Classification And Completeness Of The CAFR Cash And Investment Note	NA	0	Resolved during FY 06
FY 05	05-FAC13-40	The Finance And Administration Cabinet Should Improve Audit Documentation Over The Recording Of Year-End Accruals	NA	0	Resolved during FY 06
FY04	04-DMA4-48	The Department Of Military Affairs Should Develop An Internal Control System For The State Domestic Preparedness Equipment Support Program To Comply With OMB Circular A-133 Compliance Requirements	97.004	0	Resolved during FY 06
FY04	04-DMA5-49	The Department Of Military Affairs Should Follow Established Internal Controls Used To Ensure Compliance With OMB Circular A-133 Compliance Requirements For The Public Assistance Program	97.036	0	Resolved during FY 06

*(2) Audit findings not corrected or partially corrected:*

No findings for this section.

*(3) Corrective action taken is significantly different from corrective action previously reported:*

No findings for this section.

**COMMONWEALTH OF KENTUCKY  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

<b>Fiscal Year</b>	<b>Finding Number</b>	<b>Finding</b>	<b>CFDA Number</b>	<b>Questioned Costs</b>	<b>Comments</b>
<b><u>Material Weaknesses/Noncompliances (Continued)</u></b>					
<i>(4) Audit finding is no longer valid or does not warrant further action:</i>					
FY02	02-CWD2-32	The Division Of Unemployment Insurance Should Have A Computer System In Place To Adequately Maintain Employer Accounts	NA	0	Two or more years have passed since the audit report in which this finding was submitted to the Federal Clearinghouse. A management decision has not been issued

## **APPENDICES**

**COMMONWEALTH OF KENTUCKY  
APPENDIX 1  
FOR THE YEAR ENDED JUNE 30, 2006**

**List Of State Agencies Audited As Part Of The  
Statewide Single Audit Of The Commonwealth of Kentucky**

The list includes agencies receiving financial statement audits and/or OMB A-133 audits used for preparing the Commonwealth's CAFR. CPA reports are available upon request to the respective audited agency.

State Agencies or Funds Audited By Certified Public Accounting Firms And Included In SSWAK:

---

Kentucky Affordable Prepaid Tuition  
Kentucky Center for the Arts  
Bluegrass State Skills Corporation  
Kentucky Economic Development Finance Authority  
Kentucky Educational Television Authority  
Kentucky Higher Education Assistance Authority  
Kentucky Higher Education Student Loan Corporation  
Kentucky Horse Park Foundation  
Kentucky Housing Corporation  
Kentucky Infrastructure Authority  
Judicial Form Retirement System  
Kentucky Local Correctional Facilities Construction Authority  
Kentucky Lottery Corporation  
Office of the Petroleum Storage Tank Environmental Assurance Fund  
Council on Postsecondary Education  
Kentucky Public Employees' Deferred Compensation Authority  
Kentucky Retirement Systems  
Kentucky State Fair Board  
Kentucky Teachers' Retirement Systems  
Turnpike Authority of Kentucky  
Kentucky Worker's Compensation Funding Commission  
Kentucky Worker's Compensation Special Fund, Coal Workers' Pneumoconiosis Fund (functions of the Labor Cabinet), and Uninsured Employers' Fund (function of the Office of the Attorney General)

**COMMONWEALTH OF KENTUCKY  
APPENDIX 1  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**List Of State Agencies Audited As Part Of The Statewide Single Audit Of The Commonwealth of Kentucky (Continued)**

State Agencies Audited By Certified Public Accounting Firms And Not Included In SSWAK, Except For Expenditure Amounts In The Independent Auditor's Report In The Basic Financial Statements:

---

Eastern Kentucky University  
Kentucky Community Technical College System  
\*Kentucky State University  
Morehead State University  
Murray State University  
Northern Kentucky University  
University of Kentucky  
University of Louisville  
Western Kentucky University

\*Kentucky State University's audit report on the basic financial statements was not available at December 19, 2006. In addition, as of March 2, 2007, the OMB Circular A-133 audit report was not available.

State Agencies Audited By The Auditor Of Public Accounts:

---

Cabinet for Health and Family Services  
Department of Agriculture (Federal Awards Only)  
Department of Corrections (Financial Statements Only)  
Department of Workforce Investment  
Department of Education  
Department of Fish and Wildlife Resources (Federal Awards Only)  
Department of Military Affairs (Federal Awards Only)  
Department of Parks (Financial Statements Only)  
Department of Revenue (Financial Statements Only)  
Finance and Administration Cabinet (Financial Statements Only)  
Justice Cabinet (Federal Awards Only)  
Kentucky Access Program (Financial Statements Only)  
Kentucky Artisans Center (Financial Statements Only)  
Kentucky Department of Veterans Affairs (Federal Awards Only)  
Kentucky Office of Homeland Security (Federal Awards Only)  
Kentucky Horse Park

**COMMONWEALTH OF KENTUCKY  
APPENDIX 1  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**List Of State Agencies Audited As Part Of The Statewide Single Audit Of The  
Commonwealth of Kentucky (Continued)**

State Agencies Audited By The Auditor Of Public Accounts (Continued):

---

Kentucky River Authority  
Office of the Kentucky State Treasurer - Cash Functions  
Personnel Cabinet  
Transportation Cabinet



**COMMONWEALTH OF KENTUCKY  
APPENDIX 2  
FOR THE YEAR ENDED JUNE 30, 2006**

**List Of State Agency Contacts**

This report is available on our website, [www.auditor.ky.gov](http://www.auditor.ky.gov) in pdf format. For other requests, please contact Gregory Giesler, Open Records Administrator, with the APA's office at (502) 573-0050 or [gregory.giesler@auditor.ky.gov](mailto:gregory.giesler@auditor.ky.gov). If copies of the CAFR for the FY 06 are required, please contact John Farris, Finance and Administration Cabinet Secretary, at (502) 564-4240.

The following is a list of individuals by state agency to contact regarding findings in the Schedule of Findings and Questioned Costs or the Summary Schedule of Prior Audit Findings.

<b>State Agency</b>	<b>Contact</b>
Cabinet for Health and Family Services	Kelli Hill, Staff Assistant Office of Fiscal Services Cabinet for Families and Health Services 275 East Main Street 4C-C Frankfort, KY 40601 Phone (502) 564-8890 ext. 4336
Commerce Cabinet	George Ward, Secretary Office of the Secretary Commerce Cabinet 24th Floor, Capital Plaza Tower 500 Mero Street Frankfort, Kentucky 40601 (502) 564-4270
Department of Corrections	John D. Rees, Commissioner Department of Corrections 275 East Main Street P.O. Box 2400 Frankfort, KY 40600 (502) 564-4726
Department of Education	Hiren Desai, Director Division Financial and Material Management Department of Education Capital Plaza Tower 500 Mero Street - 16th Floor Frankfort KY 40601 (502) 564-2351

**COMMONWEALTH OF KENTUCKY  
APPENDIX 2  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**List Of State Agency Contacts (Continued)**

<b>State Agency</b>	<b>Contact</b>
Department of Employee Insurance	Scott McKenzie Office of Administrative Services Personnel Cabinet 200 Fair Oaks Lane Frankfort, KY 40601 (502) 564-0198
Department of Fish and Wildlife Resources	Darin K. Moore, Director Division of Administrative Services Department of Fish and Wildlife Resources Commerce Cabinet #1 Game Farm Road Frankfort, KY 40601 Phone (502) 564-3400
Department of Military Affairs	Rick Flynn, Chief Administrative Officer Division of Administrative Services Department of Military Affairs Boone National Guard Center 100 Minuteman Parkway, EOC Building Frankfort, KY 40601 Phone (502) 607-1545
Department of Revenue	Cathy J. Freeman Revenue Tax Policy/ Research Consultant Office of the Taxpayer Ombudsman Kentucky Department of Revenue Station 15 200 Fair Oaks Lane Frankfort, KY 40601 Phone (502) 564-7822
Department of Workforce Investment	Tommy Goins, Branch Manager Division of Fiscal Services Department for Workforce Investment 500 Mero Street 2nd Floor Frankfort, KY 40601 Phone (502) 564-3300

**COMMONWEALTH OF KENTUCKY  
APPENDIX 2  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**List Of State Agency Contacts (Continued)**

<b>State Agency</b>	<b>Contact</b>
Finance and Administration Cabinet	<p>Stuart Weatherford, Director Division of Statewide Accounting Services Finance and Administration Cabinet Capitol Annex, Room 484 702 Capitol Avenue Frankfort, KY 40601 Phone (502) 564-7750</p> <p>Ed Ross, Controller Office of the Controller Finance and Administration Cabinet Capitol Annex, Room 484 702 Capitol Avenue Frankfort, KY 40601 Phone (502) 564-2210</p> <p>Tom Howard, Executive Director Office of Financial Management Finance and Administration Cabinet Capitol Annex, Room 261 702 Capitol Avenue Frankfort, KY 40601 Phone (502) 564-2924</p>
Justice and Public Safety Cabinet-Office of the Secretary	<p>Tanya Dickinson, Branch Manager Division of Grants Management Justice and Public Safety Cabinet 125 Holmes Street Frankfort, KY 40601 Phone (502) 564-3251</p>
Office of the State Treasurer	<p>Eugene Harrell, Director Disbursement Accounts Office of the State Treasurer 1050 US Highway 127 South, Suite 100 Frankfort, Kentucky 40601 Phone (502) 564-4722</p>

**COMMONWEALTH OF KENTUCKY  
APPENDIX 2  
FOR THE YEAR ENDED JUNE 30, 2006  
(CONTINUED)**

**List Of State Agency Contacts (Continued)**

<b>State Agency</b>	<b>Contact</b>
Personnel Cabinet	Wayne Harman, Deputy Secretary Office of the Secretary Personnel Cabinet Suite 516, 200 Fair Oaks Lane Frankfort, KY 40601 Phone (502) 564-7430
Transportation Cabinet	Alice Wilson, Deputy Executive Director Office of Budget & Fiscal Management Transportation Cabinet 200 Mero Street Frankfort, KY 40601 Phone (502) 564-4550